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SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER LEHMAN BROTHERS

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January 17, 1974

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LEHMAN BROTHERS,

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JACOB SCHEIN, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER LEHMAN BROTHERS

Opinions Below

The majority and dissenting opinions of the Court of Appeals, rendered on May 10, 1973, are reported at 478 F.2d 817 (61a)[1]. The opinion of the District Court, which was reversed by the Court of Appeals, is reported at 335 F. Supp. 329 (50a).

1. Citations with the suffix "a" are to the Single Appendix of the Record, prepared in connection with this matter and Nos. 73-440 and 73-495.

Jurisdiction

The judgment of the Court of Appeals was entered on May 10, 1973, and a timely petition for rehearing, filed by the petitioner herein, was denied by the Court of Appeals on June 8, 1973 (85a). The petition herein was filed on September 6, 1973. On December 3, 1973 this Court granted the writ of certiorari, limited to the following question:

> "Did the Court of Appeals for the Second Circuit err in not certifying the question of Florida law to the Florida Supreme Court pursuant to Florida's certification procedure? Fla. Stat. Ann. Sec. 25.032 (1961), Fla. App. Rules, R. 4.61 (1967)."

The jurisdiction of the Court is invoked under 28 U.S.C. §1254(1).

Question Presented

In this diversity action brought in the Southern District of New York, but governed by Florida law, should the Court of Appeals have certified the decisive issue of law to the Supreme Court of Florida, pursuant to Florida's statutory certification procedure, to permit the Supreme Court of Florida to decide whether a novel rule of public policy would become the law of Florida, in a situation where Florida's interests are vital and paramount?

Statutes Involved

Florida law, FLA. STAT. ANN. §25.031 (1961), provides that

> "The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit

> court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer."

In addition the Supreme Court of Florida is enabled by statute to effectuate §25.031 by rulemaking, FLA. STAT. ANN. §25.032 (1961):

> "The supreme court of this state is hereby authorized and empowered to collaborate with any and all other courts of last resort, of other states and of the United States, in the preparation and approval of uniform rules of court to make effective this and similar laws."

Pursuant to §25.032, the Supreme Court of Florida promulgated FLA. APP. RULES, R. 4.61 (1967):

> RULE 4.61. Certified Questions from Federal Courts
>
> a. When Certified. When it shall appear to the Supreme Court of the United States, or to any of the Courts of Appeal of the United States that there are involved in any proceeding before it questions or propositions of law of this state which are determinative of said cause and that there are no clear controlling precedents in the decisions of the Supreme Court of this state, such federal appellate court may

certify such questions or propositions of law of this state to the Supreme Court of Florida for instructions concerning such questions or propositions of state law.

b. Jurisdiction. Questions or propositions of law referred to in sub-paragraph a hereof shall be certified for answer to the Supreme Court of this state.

c. Method of Invoking Rule. The provisions of this rule may be invoked by any of the federal courts referred to in sub-paragraph a hereof upon its own motion or upon the suggestion or motion of any interested party when approved by such federal court.

d. Contents of Certificate. The certificate provided for herein shall contain the style of the case, a statement of facts showing the nature of the cause and the circumstances out of which the questions or propositions of law arise and the question of law to be answered.

e. Preparation of Certificate. The certificate may be prepared by stipulation or as directed by such federal court. When prepared and signed by the presiding judge of said federal court, it shall be certified to the Supreme Court by the Clerk of the federal court and under its official seal. The Supreme Court may, in its discretion, require the original or copies of all or any portion of the record before the federal court to be filed with said certificate where, in its opinion, such record may be necessary in the determination of said cause.

f. Costs of Certificate. The costs of the certificate and filing fee shall be equally divided between the parties unless otherwise ordered by this Court.

g. Briefs and Argument. The appellant or moving party in the federal court shall file and serve upon its adversary its brief on the question certified within 30 days after the filing of said certificate in

the appellate court of this state having jurisdiction. The appellee or responding party in the federal court shall file and serve upon its adversary its brief within 20 days after the receipt of appellant's or moving party's brief and a reply brief shall be filed within 10 days thereafter.

h. Oral Argument. Oral argument may be granted upon application and, unless for good cause shown the time be enlarged by special order of the Court prior to the hearing thereon, the parties shall be allowed the same time as in other causes on the merits.

Statement of the Case

The district court had jurisdiction of this matter solely on the basis of diversity of citizenship, 28 U.S.C. §1332(a)(1). Three similar shareholder's derivative suits[2] were filed in the Southern District of New York[3] naming Lehman Brothers ("Lehman") and others as defendants. These actions have been consolidated throughout and are so treated here.[4] Respondents Schein and Gregorio, plain-

2. *Gildenhorn* v. *Lum's, Inc.*, No. 70 Civ. 5733 (filed Dec. 29, 1970); *Gregorio* v. *Lum's, Inc.*, No. 71 Civ. 1925 (filed Jan. 12, 1971); and *Schein* v. *Chasen*, No. 71 Civ. 4218 (filed Sept. 24, 1971).

3. The *Gregorio* case was originally filed in the Northern District of Illinois but was transferred by consent.

4. Only the *Schein* and *Gregorio* cases are involved here, since an appeal in *Gildenhorn* was not pursued. The full captions of the actions, indicating the alignment of the parties, are as follows:

Jacob Schein & Marvin H. Schein, Plaintiffs,

v.

Melvin Chasen; Investors Diversified Services, Inc.; Lehman Brothers; Investors Variable Payment Fund, Inc.; Benjamin Simon; IDS New Dimensions Fund, Inc.; Eugene S. Sit; James R. Jundt; and Lum's Inc., Defendants.

Antone F. Gregorio, Plaintiff,

v.

Lum's, Inc.; Melvin Chasen; Lehman Brothers; Investors Diversified Services, Inc.; Eugene C. Sit; and James R. Jundt, Defendants.

tiffs below ("plaintiffs"), sue as shareholders of the nominal defendant, Lum's, Inc. ("Lum's"), a Florida corporation with its headquarters in Miami.

The complaints allege that on January 8, 1970 the defendant Melvin Chasen, then president of Lum's, placed a call from his office in Miami to the defendant Benjamin Simon, then a registered representative in Lehman's Chicago office, and told him about certain disappointing projections of Lum's earnings. These estimates were not then public. Allegedly Simon thereafter told an employee of the IDS defendants[5] in Minneapolis[6] about them. On the next day the IDS defendants allegedly sold 83,000 shares of Lum's common stock on the New York Stock Exchange at about $17.50 per share. Later that day the Exchange halted trading in Lum's stock, whereupon the company announced that projected second-quarter earnings would be "substantially lower" than anticipated and that first-half earnings would be about 20% below the previous year's level (18a ¶ 23; 29a ¶ 20). Lum's stock opened at $14.00 per share on the next trading day (19a ¶ 24).

The *Schein* complaint alleges that the unfavorable earnings estimates were the "property" of Lum's (17a ¶ 18), that Chasen learned of them in a fiduciary capacity (17a ¶ 16) and told the other defendants about them in violation

5. Investors Diversified Services, Inc.; Investors Variable Payment Fund, Inc.; and IDS New Dimensions Fund, Inc., respondents herein and petitioners in No. 73-495, were defendants below in the *Schein* action and are collectively referred to as "the IDS defendants." Of these parties, only Investors Diversified Services, Inc. is a defendant in the *Gregorio* action.

6. Eugene S. Sit and James R. Jundt, defendants in both the *Schein* and *Gregorio* cases, are alleged to be employees of Investors Diversified Services, Inc. Allegedly Simon told Sit about the projections, and Sit told Jundt (17a ¶ 19; 28a ¶ 17). Both Sit and Jundt were dismissed from the cases by the District Court for lack of personal jurisdiction (51a n.1). There was no appeal from this dismissal (63a n.1).

of that duty (20a ¶ 25). It states that the other defendants "aided and abetted" (*Id.*) such violation, used the estimates "for their own personal profit" (*Id.*) and "are liable to Lum's for their unlawful profits (including commissions)" and for "the damages it sustained thereby" (*Id.*). The *Gregorio* complaint alleges that the disappointing earnings projections were "an asset" of Lum's (30a ¶ 22) and that defendants "must account to Lum's Inc. for the profits realized by them" (*Id.*).

Lehman, Simon, Chasen, and the IDS defendants moved to dismiss the complaints for failure to state a claim on which relief could be granted, FRCP 12(b) (6) (33a, 38a, 41a, 45a). Affidavits of Simon, Chasen, and Mr. Herbert Lisle, a Lehman partner (36a, 44a, 48a), were presented on the motion and not excluded, FRCP 12(b). These established that the IDS defendants' sales were not made through Lehman Brothers and that neither Lehman nor Simon received any benefit from the sales. Thus it is undisputed[7], as the District Court stated, that the "broker-dealer defendants . . . did not profit by virtue of the sales" (55a).

In their brief in the District Court the plaintiffs urged that Lum's should recover "for the misappropriation of confidential information belonging to Lum's by its fiduciary (Chasen) and his tippees (the other defendants)", under the theory of *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 248 N.E. 2d 910 (1969).[8] In *Diamond* the New York Court of

7. Plaintiffs had thirty days in which to file papers in opposition; they filed neither affidavits suggesting any factual issue, nor affidavits showing inability to present contrary evidence, FRCP 56(f). Thus there is no dispute that Lehman received no benefit in the transactions sued upon, FRCP 56(c).

8. Memorandum of Plaintiffs Jacob Schein, Marvin H. Schein, and Antone F. Gregorio in Opposition to Defendants' Motion to Dismiss for Failure to State a Claim or to Stay and to Dismiss for Want of Personal Jurisdiction 4-5 (Nov. 3, 1971) (cited herein as "Memorandum for Plaintiffs").

Appeals held that officers and directors of a corporation would be liable to the corporation in a derivative action for the profits they allegedly made by selling the company's stock based on inside information. The opinion is phrased in conventional terms of fiduciary duties, reasoning that inside information was an "asset" of the corporation which had been acquired by the insiders as fiduciaries of the company and misappropriated in violation of trust. But since under the usual rule a company can only recover from an insider who appropriates a lawful business opportunity, and since the company never had a lawful opportunity to sell stock on inside information, Diamond's holding that the company has "a higher claim to the proceeds," *id.*, 24 N.Y. 2d at 498, of wrongful market activity was a novel break from precedent. Plaintiffs argued that whether New York or Florida law applied the defendants were liable under the *Diamond* theory, claiming that "Flordia cases contain appropriately phrased holdings with respect to corporate directors' and officers' fiduciary obligations similar to those used in establishing the *Diamond* v. *Oreamuno* holding."[9]

Since none of the defendants, except Chasen, was a "fiduciary" of Lum's, plaintiffs further urged the court, in "the interests of public policy"[10], to apply the *Diamond* rule to non-fiduciaries too. In support of such policy they cited several rulings under §10(b) of the Securities Exchange Act, 15 U.S.C. §78j(b)[11].

9. Memorandum for Plaintiffs, 7-8.

10. Memorandum for Plaintiffs, 14.

11. *Levine* v. *Seilon*, 439 F.2d 328 (CA2 1970); *Kuehnert* v. *Texstar Corp.*, 412 F.2d 700 (CA5 1969); *Nathanson* v. *Weis, Voisin, Cannon, Inc.*, 325 F.Supp. 50 (SDNY 1971); *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *Investors Management Co.*, SEC Securities Exchange Act Release No. 9267 (1971); *Cady, Roberts & Co.*, 40 SEC 907 (1961).

The District Court, Hon. Harold R. Tyler, Jr., J., rejected plaintiffs' claims that New York substantive law applied. Following New York choice of law principles, as required under *Klaxon Co.* v. *Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941), it held that the law of the state of incorporation, here Florida, governed the nature of fiduciary obligations to a corporation (52a-53a). For the New York Court of Appeals expressly stated in *Diamond* itself, concerning fiduciary duties to corporations, that the

> "primary source of law in this area ever remains that of the State which created the corporation." *Diamond* v. *Oreamuno, supra,* 24 N.Y.2d at 503-04.

The same result was reached under a "grouping of contacts" choice of law theory, since the significant events occurred in Florida (53a). Moreover, under the "governmental interest" analysis recently stressed by New York courts, Florida law necessarily controls, because

> "Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders" (53a).

Judge Tyler noted that, although the Florida Supreme Court had not ruled on the issue, several Florida appellate courts held that a shareholder's derivative complaint against a corporate fiduciary was insufficient if it failed to allege damage to the corporation (54a).

Recognizing that the *Schein* complaint contained at least a "bare allegation" of "damage" (54a) and also that the *Diamond* theory developed by New York might be pressed upon a Florida court, Judge Tyler also tested the complaints under *Diamond,* on which the plaintiffs relied. He held that even assuming Florida adopted *Diamond,* none

of the defendants in these cases would be liable. Chasen was a fiduciary, but he sold no stock and made no profits.[12] The IDS defendants might have profited, but they were not fiduciaries. And Lehman and Simon were excluded on two grounds, since they had no fiduciary relationship toward Lum's, and they made no profits (54a-55a). The District Court could not accept the plaintiffs' "more expansive view" (55a) of *Diamond*, which would hold liable non-fiduciaries like IDS and Lehman, particularly where such "outside individuals, corporations, or institutions" were already "subject to other private and governmental restraints on their behavior" (56a). The complaints were dismissed. The plaintiffs appealed.[13]

In the Second Circuit the plaintiffs no longer directly relied on *Diamond* v. *Oreamuno, supra*. Rather they conceded that Florida law governed, since Lum's is a Florida corporation.[14] They produced no Florida precedents supporting the *Diamond* theory and cited Florida cases only to show that a corporation suing a fiduciary need show no damage to it other than the appropriation of a business opportunity, and that Florida recognizes informal as well as formal fiduciary relationships.[15] They urged that the Second Circuit should assume that Florida would decide

12. The District Court was not required to decide whether Chasen, the only fiduciary in the case, might come within an expanded view of *Diamond*, since he was dismissed as improperly served (56a). His dismissal was not contested on appeal (63a n.1).

13. An appeal in the *Gildenhorn* case was noted but not pursued and accordingly was dismissed, *Gildenhorn* v. *Lum's Inc.*, No. 72-1374 (CA2 April 5, 1973).

14. Brief for Appellants Jacob Schein, Marvin H. Schein, and Antone F. Gregorio 5 n.1 (Feb. 14, 1972) (cited herein as "Brief for Appellants"); Reply Brief for Appellants Jacob Schein, Marvin H. Schein, and Antone F. Gregorio 2 (October 31, 1972) (cited herein as "Reply Brief").

15. Brief for Appellants 5-6, 8-14.

to adopt *Diamond* from New York[16] and to extend its application to coincide with tippor-tippee liability under federal law, which they discussed at length.[17]

The Court of Appeals reversed, in an opinion by Judge Waterman (61a). The court said that, "[i]deally, the federal court sitting in a diversity action applies the applicable state law as it has been enunciated by the highest court in the state" (66a). But the court found no pertinent Florida rulings, and it felt free "to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case . . . bears on the issues . . ." (*Id.*). The court proceeded from the assumption that Florida would adopt *Diamond:*

> "In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond,* as so interpreted, to the facts presented here" (66a-67a).

The court said the only question was "whether the *Diamond* holding should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment" (67a). Conceding that no such "common enterprise" between Chasen and the other defendants was actually alleged, the court said that the alleged "sequence of events" would "substantiate" (*Id.*) such an enterprise, citing antitrust cases on proof of conspiracy by evidence of "conscious parallelism." Since the court below found "nothing in the language of *Diamond*" which excluded "co-venturers" of a

16. Brief for Appellants 6-8, 10, 15-16; Reply Brief 3-4, 7-9.

17. Brief for Appellants 10-12, 15; Reply Brief 4, 6, 9-10.

fiduciary from joint and several liability, it found that all the defendants came within *Diamond* (68a).

The court went further, holding that all the defendants themselves became fiduciaries of Lum's, under Florida law, by "the acquisition of confidential information which is 'owned' by someone else" (70a).

The Court of Appeals stated that the "cleansing" and "prophylactic effect" of "*Diamond*, the law of jurisdiction in which the New York Stock Exchange is located", might be endangered if outsiders were "immunized" (69a). It stressed the "strong desirability of tightening the law of insider trading" (70a) and the particular need for a state law doctrine to impose liability where federal remedies might be impractical (69a). It noted that the principle it enforced—"as between the defendants and Lum's, there can be no doubt that it would be inequitable to permit the defendants to keep the rewards of the fraud" (70a) had been applied in an SEC action under the federal securities laws, where the corporation was ordered to receive and hold illegal profits, subject to the claims of injured parties[18], and observed that decisions under the Securities Exchange Act had developed the concepts of "tippor" and "tippee" liability, which were analogous to the principle under which Lehman and Simon were accountable as "participants" (71a, 72a n.8).

Defendants had pointed out that a corporate recovery might expose them to double liability, since purchasers of

18. The court cited both *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (CA 2), *cert. denied*, 404 U.S. 1005 (1971) and *SEC* v. *Golconda Mining Co.*, 327 F.Supp. 257 SDNY 1971), but *Golconda* is a miscitation, since it did not permit a corporate recovery; rather the funds were paid into the registry of the court.

the stock had also sued them.[19] The court dismissed this argument, saying that since the defendants were "fully aware" of such suits, they were "well able to protect themselves from multiple liability" (73a). Thus the "Florida law", as conceived by the court below, gives a Florida corporation a recovery of insiders' trading profits only if those with whom its fiduciaries deal do not recover, and it permits injured parties to appropriate for their personal benefit the value of the corporate "asset" which a fiduciary "misappropriated". The court cited no Florida cases for this principle.[20]

Judge Kaufman dissented (73a). He emphasized that those who trade on inside information deserve "universal condemnation" (*Id.*) but protested that in responding to that sentiment his brethren had invented a "totally new concept of law" that was wholly without precedent even under the law of New York (74a). He pointed out that the foundation of the majority's theory, a fiduciary duty running to the corporation, did not exist here:

> "The complaints here are barren of any allegation that the appellees—or Sit or Jundt—occupied any

19. The court noted that a private suit by an alleged purchaser of Lum's stock, *Sanders* v. *Lum's, Inc.*, 70 Civ. 5331 (SDNY), and an agency action, *SEC* v. *Lum's, Inc.*, 70 Civ. 5280 (SDNY), had been brought (72a). The *Sanders* case is still pending. The SEC action was tried in April and May of 1973. The District Court ruled in that case that Lehman Brothers did not violate the Securities Exchange Act and dismissed the complaint against Lehman, *SEC* v. *Lum's, Inc.*, CCH FED. SEC. L. REP. ¶94,134 (SDNY Sept. 13, 1973). No appeal was taken.

20. The court cited the decision under the Securities Exchange Act which developed the concept of a conditional corporate recovery. *SEC* v. *Texas Gulf Sulphur Co.*, 312 F.Supp. 77, 93 (SDNY 1970), *aff'd in part, rev'd in part* 446 F.2d 1301 (CA2), *cert. denied*, 404 U.S. 1005 (1971).

> position, such as officer, director, employee, or agent, which would create fiduciary obligations to Lum's" (76a-77a).

He contrasted the case with decisions, which the majority employed as authority, involving defendants who had positions involving responsibilities toward the plaintiff:

> "*Compare Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). Liability in *Diamond* was predicated entirely on such a relationship, and in its absence, the *Diamond* rationale for liability ceases to exist" (77a).

The majority, he said, tried to "bridge this fatal gap" (*id.*) by using a "common enterprise" notion, which was not alleged in the complaints and seemed wholly "fictional" (*id.*). Rather the complaints, generously read, disclosed "nothing more than a seemingly unsolicited and haphazard revelation of certain information" (*id.*). The joint venture and aiding and abetting concepts were unavailable, since

> "there is not a word in the complaint charging that the appellees actively solicited the disclosure or that they had concocted a prearranged scheme with Chasen. We are dealing here with an isolated transaction" (78a) (footnote omitted).

The idea that *all* the defendants were "fiduciaries" had no basis either, in Judge Kaufman's view. Although federal cases expanding the liability of "tippee" traders appropriately enforced an individual's duty owed to persons with whom he traded, such cases could not be used to answer the wholly different question whether

> "*under state common law,* tippee trading is a breach of a fiduciary duty owed to the corporation whose

> shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action" (79a) (italics original).

The idea that a "tippee" is a state-law "fiduciary" seemed to Judge Kaufman "an unknown and untenable legal concept" (*Id.*), supported neither by agency principles nor by fiduciary principles, even as altered by *Diamond.*

Underlying the majority's error, Judge Kaufman recognized, was the assumption that Florida would adopt *Diamond,* "itself a significant alteration of the common law principles applicable to an officer's or director's trading in his corporation's shares" (79a-80a):

> "Yet because there are no pertinent Florida decisions, the majority focuses on a New York decision, *Diamond* v. *Oreamuno, supra.* Thus, liability is founded on the conclusion of two federal judges that the Florida Supreme Court, if the instant case was before it, would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case" (79a).

Because he was convinced that the majority had exceeded "its authority by substituting its own view of what state law ought to be, for what the state law actually is" (80a), Judge Kaufman concluded that there was only one way to deal justly with the case. He urged the majority to use the "enlightened" (*Id.*) Florida certification procedure, which authorizes the Supreme Court of Florida to answer, by written opinion, questions of Florida law certified to it by federal appellate courts. He noted that the procedure was used by this Court and by the Fifth Circuit, and he could not comprehend why the majority had refused to do so

here (80a). If the Second Circuit certified the issue, he said,

> "The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally" (81a).

Lehman moved for rehearing, pointing out that *Diamond* v. *Oreamuno, supra,* was an extreme minority position, if not a unique one, and that the majority had erred in assuming that Florida would both adopt it and expand it. Lehman specifically requested that the Second Circuit certify the question to the Supreme Court of Florida for authoritative resolution by it pursuant to the statutory certification procedure, FLA. STAT. ANN. §§25.031-25.032 (1961); FLA. APP. RULES, R. 4.61 (1967).[21] The petition was denied (85a).

Summary of Argument

Well-established doctrines of abstention fix the boundaries of the jurisdiction of the federal courts. The early dictum that "to decline the exercise of jurisdiction which is given" would be "treason to the Constitution," *Cohens* v. *Virginia,* 19 U. S. (6 Wheat.) 264, 404 (1821), has been proved too rigid in practice.[22] Rather, federal courts define their functions with an eye to "the appropriate relationship between federal and state authorities functioning as a har-

21. Suggestion for Rehearing in Banc by Appellee Lehman Brothers, at 9-10 (May 24, 1973).

22. Indeed, Professor Wright states that "[i]t is probably true that there never was such a rule, uniformly applied, in federal courts." Wright, *The Abstention Doctrine Reconsidered,* 37 TEXAS L. REV. 815 (1959).

monious whole", *Chicago* v. *Fieldcrest Dairies, Inc.*, 316 U.S. 168, 172-73 (1942), and will abstain from decision in order to avoid unnecessary disruption within the federal system:

> "Reflected among the concerns which have traditionally counseled a federal court to stay its hand are the desirability of avoiding unseemly conflict between two sovereignties, the unnecessary impairment of state functions, and the premature determination of constitutional questions." *Martin* v. *Creasy*, 360 U.S. 219, 224 (1959).

Accordingly, this Court has repeatedly declared that it is the duty of federal courts to abstain from exercising their jurisdiction rather than to formulate important new principles of public policy in areas subject to state regulation. See, *e.g.*, *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968); *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959); *Burford* v. *Sun Oil Co.*, 319 U.S. (1943).

Instead of abstaining here, the majority took the bit in its teeth and forged a radical new framework of regulation for Florida corporations based on its own notions of good public policy. It enacted as "the law of Florida" a new rule whereby the profits of insider trading are forfeited to the company whose shares were traded. Although this rule purports to enforce "fiduciary" duties, it in no way protects the corporation from loss, since it awards it a windfall recovery of profits which it could not legally make. This recovery is in no sense compensatory, and indeed the corporation may one day have to give it up. Rather the forfeiture has only the purpose of deterring unfairness to third persons—those with whom the insider dealt. Since this new theory fails to remedy any wrong to such persons, and indeed may make it difficult or impossible for them to recover their damages, it is the result of a basic policy

decision to emphasize deterrence at the expense of compensation. This concept has no source in Florida statutes or decisions; it was only recently conceived in New York State, in an explicit attempt to avoid the shortcomings of federal remedies by enabling any shareholder to bring a derivative suit, and has been adopted nowhere else.

Moreover the decision goes far beyond even New York's radical departure, by exposing to this novel sanction not just corporate insiders but every person who receives confidential information about a corporation, even persons who have no connection with that corporation, such as Lehman. By artificially labeling outsiders as "fiduciaries", this new rule is at war with Florida decisions. More basically, this limitless expansion of the "fiduciary" class shows that the novel penal rule has nothing to do with protecting the corporation or preserving the loyalty of corporate insiders but rather was created as a deterrent to police all market trading. It is not an extension or modification of any "fiduciary" rules; rather it is a new regulatory mechanism made up out of whole cloth. Under this Court's rulings in *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* and *Louisiana Power & Light Co.* v. *City of Thibodaux, supra,* abstention was clearly required, to permit the courts of Florida to determine whether to adopt such a radical new principle, which broadly affects the shareholders and management of every Florida corporation.

The court below erred even more fundamentally, because the purposes of abstention could be fully achieved by a simpler, less costly procedure. The Legislature of Florida has made its Supreme Court available to answer questions concerning state law which are certified to it by federal appellate courts. In that way the crucial issues in this case could have been decided authoritatively and quickly by the Supreme Court of Florida, the body which must one day

declare the state's public policy in any event. A definitive ruling would have been secured in this case without substantial delay or expense and without limiting federal jurisdiction over any aspect of this case except the state law, which the court below was not entitled to declare. In the years since the Court first urged its use in *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960), this certification procedure has been proved in practice by the Court of Appeals for the Fifth Circuit and by this Court. There is no tenable basis for the refusal to use the certification procedure, as Judge Kaufman in dissent urged the majority to do. The majority gave no reasons at all and simply ignored the point.

The refusal of the court below to employ certification demonstrates its determination in this case to act without regard to Florida law. The decision below has denied Florida the right to formulate its public policy through the organs of its own government, a right it specifically sought to preserve by adopting the certification procedure. It has created disuniformity in the application of state law, worked an injustice in this particular case and bred uncertainty and confusion as to the applicable rules. All of these undesirable consequences would have been avoided by certification.

If the federal courts are truly devoted to the fair and efficient enforcement of rights and duties as they are defined by state courts, and if the national judicial system is to develop along modern lines to that end, the decision below cannot stand.

ARGUMENT

POINT I

The decision below imposes a new regulatory framework upon trading in the stock of Florida corporations.

Prior to the decision of the New York Court of Appeals in *Diamond* v. *Oreamuno, supra,* the springboard for the decision below, it was generally said that the "common law rule precludes corporate recovery of profits made by insiders on dealings in the corporation's stock." Note, 1970 WIS. L. REV. 576, 577 (1970). Indeed "no common law judicial authority existed", Note, 37 FORDHAM L. REV. 477, 478 n.8 (1969), for any such recovery by the corporation. Courts reasoned that, since a corporation has no interest in shares of its stock owned by others, it cannot claim to be injured in transactions in such shares. See Note, 18 BUFFALO L. REV. 193, 194 (1969). The only "fiduciary" duty that an insider might owe in such context, recognized by some courts, was a limited duty toward an individual with whom he dealt. See *Strong* v. *Repide,* 213 U.S. 419, 431 (1909); *Chenery Corp.* v. *SEC,* 128 F.2d 303, 307 (CADC 1942), *rev'd on other grounds,* 318 U.S. 80 (1943); cf. *Rogers* v. *Riddle,* 128 So.2d 409 (Fla. App.), *cert. denied,* 133 So.2d 645 (Fla. 1961); Note, 22 VAND L. REV. 1412, 1414-15 (1969); Note, *supra,* 18 BUFFALO L. REV. at 194.

Corporate recovery from an insider on fiduciary principles, prior to *Diamond,* required proof of loss to the corporation, for example, by the misappropriation of a cor-

porate business opportunity or asset or competition with the corporation:

> "The principle that directors are fiduciaries of their corporations is amply supported by New York case law. Its application, however, has always been in holding directors liable for making personal profits from transactions entered into or which should have been entered into on behalf of the corporation, taking advantage of corporate opportunities, diverting corporate assets, competing with the corporation, or making extra profits when selling control of the corporation. Further, in each case, where a director has been held liable to the corporation on fiduciary grounds, there existed damage to the corporation. . . ." Note, *supra,* 37 FORDHAM L. REV. at 478-79 (footnotes omitted).

Thus, prior to *Diamond,* no New York decision "held directors accountable to their corporation for profits made *unless* the corporation sustained some loss or harm by the director's action." Note, *supra,* 18 BUFFALO L. REV. at 197 (italics original); see also Note 45 NOTRE DAME LAW, 314, 319, 321 (1970). This was the ordinary rule with respect to stock transactions in particular:

> "But a director or officer does not ordinarily violate his fiduciary duty to the corporation by dealing in its stock, unless the corporation is thereby harmed. Accordingly, insider accountability has been limited to purchases which usurped a corporate opportunity and sales which improperly effected a transfer of corporate control." Note, 55 VA. L. REV. 1520, 1522-23 (1969) (footnotes omitted).

Moreover, while a director had a duty not to appropriate corporate assets, see, *e.g., Marcus* v. *Otis,* 168 F.2d 649

(CA2), *modified,* 169 F.2d 148 (1948), his use of corporate information alone was not viewed as such a misappropriation if he did not also appropriate a business opportunity:

> "None of these [prior New York] cases support the proposition that the use of inside information is per se a breach of fiduciary duty. Rather, they hold that the particular manner in which the information is used gives rise to the breach of fiduciary duty, such as where use of the information amounts to a usurpation of a corporate opportunity or results in competition with the corporation." Note, *A Comparison of Insider Liability Under Diamond* v. *Oreamuno and Federal Securities Law,* 11 B. C. IND. & COM. L. REV. 499, 502-03 (1970).

In other words, taken alone, "[i]nside information, however, has generally not been considered an asset of the corporation", Note, *supra,* 37 FORDHAM L. REV. at 480. This rule may be contrasted with the stricter standards imposed on conventional trustees outside the corporate context. Compare *Mosser* v. *Darrow,* 341 U.S. 267, 271 (1951); see Note, *Diamond* v. *Oreamuno: A Fresh Approach to Insider Trading and the Duties of the Corporate Fiduciary,* 31 U. PITT. L. REV. 296, 298 (1969); Note, *supra,* 1970 WIS. L. REV. at 580.

Recovery on a "corporate opportunity" theory rests on the premise that the opportunity would have been of value to the corporation, see Note, *supra,* 1970 WIS. L. REV. at 581. A corporation, however, could not legally sell its own stock on inside information or retain the profits of such a transaction. Therefore, it sustains no loss when an insider does so for his own account, and there is no logical basis for a corporate recovery of his profits:

> "It would have been illegal under federal securities law for the corporation to sell its shares on the basis of the inside information. Thus, the defendants' actions can not be construed as diverting a corporate opportunity or competing with the corporation since

> the corporation itself was prohibited from engaging in the transaction." Note, *supra,* 11 B. C. IND. & COM. L. REV. at 503.

It is specifically held in proceedings to enforce Rule 10b-5 against persons who sold stock on inside information for the account of others that the "obligations of a fiduciary do not include performing an illegal act," *Investors Management Co., Inc.,* SEC Securities Exchange Act Release No. 9267, at 14 (July 29, 1971); see also *Cady, Roberts & Co.,* 40 S.E.C. 907, 916 (1961). Compare *Mosser* v. *Darrow, supra; Norte & Co.* v. *Huffines,* 304 F. Supp. 1066, 1109 (SDNY 1968), *aff'd in pertinent part,* 416 F.2d 1189 (CA2 1969), *cert. denied,* 397 U.S. 989 (1970); *Brophy* v. *Cities Service Co.,* 31 Del. Ch. 241, 70 A.2d 5 (1949) (fiduciaries competing with principal's wholly lawful plan to purchase corporate securities); see also Note, *supra,* 55 VA. L. REV. at 1525; Note, *supra,* 37 FORDHAM L. REV. at 479-480.

Florida decisions specifically state that a corporation cannot recover the profits made by corporate fiduciaries in personal transactions, when such transactions do not interfere with the business of the corporation. *Doeg* v. *Thornton,* 174 So.2d 570, 573 (Fla. App. 1965); *Renpak, Inc.* v. *Oppenheimer,* 104 So.2d 642, 644 (Fla. App. 1958) . Likewise, the fiduciary duty of a director is defined as a duty not "to act in hostility to the interest of the corporation," *Etheredge* v. *Barrow,* 102 So.2d 660, 662 (Fla. App. 1958). See also Sowards, *Corporations and Corporate Finance,* 14 U. MIAMI L. REV. 575, 577 (1960) (fiduciary of Florida corporation "accountable for personal profits arising from opportunities which rightfully belong to the corporation or for profitable activities which stem from a conflict of interest"). Since insider trading usurps no corporate opportunity and involves no conflict of interest, it is not a fiduciary violation under Florida law, and the corporation has no right to recover the profits.

Florida adheres to the general rule that a suit seeking a judgment in favor of a corporation must allege that the

defendant caused some loss to the corporation. Its courts specifically so hold in shareholder's derivative cases like this one:

> "Thus, in order for a complaint to state a cause of action entitling the stockholder to relief, it must allege two distinct wrongs: the act whereby the corporation was caused to suffer damage, and a wrongful refusal by the corporation to seek redress for such act." *James Talcott, Inc.* v. *McDowell,* 148 So.2d 36, 38 (Fla. App. 1962).

This principle has been repeatedly applied. ***Palma*** v. *Zerbey,* 189 So.2d 510 (Fla. App. 1966), *cert. denied,* 200 So.2d 814 (Fla. 1967); ***Maronek*** v. ***Atlantis Hotel, Inc.,*** 148 So.2d 721 (Fla. App. 1963).[23]

When wrongful acts cause a direct injury to a shareholder "which is separate and distinct from that sustained by other shareholders," the remedy is an individual suit. *Citizens National Bank* v. *Peters,* 175 So.2d 54, 56 (Fla. App. 1965). In contrast, a derivative action is proper if "the injury is primarily against the corporation, or the stockholders generally. . . ." *Id.* Since making profits by insider trading causes a "separate and distinct" injury to the persons who bought stock, under Florida law a suit for such profits must be brought by those shareholders individually, and not by the corporation, which has suffered no such loss.

The court below rejected all such limitations, relying on the New York decision, *Diamond* y. *Oreamuno, supra. Diamond* held that a corporation could recover profits made

23. The court below found *Palma* "totally unpersuasive", since it "failed to provide a discussion of the issues" and was a per curiam opinion by "a lower Florida court" (72a n.9). But the issue is so well grounded in Florida law that no "discussion" was called for, and to ignore a reported appellate decision squarely violates *West* v. *American Tel. & Tel. Co.,* 311 U.S. 223 (1940), and *Six Companies of Calif.* v. *Joint Highway Dist. No. 13,* 311 U.S. 180 (1940). Moreover, *Palma* was taken to the Supreme Court of Florida, and that court denied certiorari.

by officers and directors who sold stock based on inside information, even though the corporation sustained no loss, the insiders had not deprived the corporation of any asset, and their wrongful market activity was not a business opportunity legally available to the corporation. *Diamond* is "unique in both its reasoning and conclusion," Note, *supra,* 37 FORDHAM L. REV. at 478. Since it overruled "what has apparently been accepted law in the lower courts of New York for some time," Note, *supra,* 18 BUFFALO L. REV. at 198, *Diamond* plainly was based on concerns which were theretofore irrelevant to fiduciary liability, and has a purpose entirely different from that which governed earlier cases.

Diamond is a piece of creative judicial legislation. Although couched in familiar terms of corporate fiduciary duties, it does not seek to enforce duties of loyalty to the corporation nor to compensate any wrong to the corporation. Its premise is, rather, the need to deter directors from trading based on inside information. The New York Court of Appeals in *Diamond* reviewed existing federal remedies under Rule 10b-5[24] and §16b[25] and found them "rather limited". 24 N.Y.2d at 502. Therefore, it frankly decided to create judicially a common-law rule to deter conduct prejudicial not to the corporation but to "outsiders"—buying and selling shareholders.

> "In view of the practical difficulties inherent in an action under the Federal law, the desirability of creating an effective common-law remedy is manifest." 24 N.Y.2d at 503.

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24. 17 C.F.R. §240.10b-5 (1973).

25. 15 U.S.C. §78p(b).

Practice under §16(b) had shown that "a derivative action can be an effective method for dealing with such abuses," *id.*, 500, and the New York court decided to rely upon the "private Attorney General", *id.*, 503, to administer its new enforcement tool. Thus, in contrast with the federal right of action for persons injured by insider trading, *Diamond* enables any shareholder to bring suit:

> "*Diamond's* derivative action is a somewhat better deterrent than either the federal court's solution [in *SEC* v. *Texas Gulf Sulphur Co.*, 312 F.Supp. 77 (SDNY 1970), *aff'd in part, rev'd in part* 446 F.2d 1301 (CA2), *cert. denied*, 404 U.S. 1005 (1971)] or class actions, since there are more parties—all the stockholders—who can initiate a derivative suit." Note, 83 HARV. L. REV. 1421, 1426 (1970) (footnotes omitted).

But recovery under *Diamond* does nothing for those who are actually damaged by insider trading. Thus this new right of action is in no sense a "remedy", since injured parties are not compensated, and its only purpose is to regulate insiders' conduct by its supposed deterrent effect. It is a new regulatory device, created by the New York court because it believed federal law had not then developed sufficiently to provide an effective deterrent:

> "The essence of *Diamond* is that the derivative suit is the only practicable method for regulating insider trading on the securities market. The real victims of nondisclosure are admittedly the parties with whom directors deal, but neither federal nor state law has armed buyers and sellers with a sufficiently effective private cause of action to discourage directors from exploiting their privileged position. Derivative plaintiffs must therefore be allowed to serve as 'private Attorney[s] General' if fiduciary stand-

> ards are to be faithfully observed. Allowing the uninjured corporation to recover is justified because the windfall and the substantial attorney's fees inevitably accompanying it afford an incentive for private 'prosecutions'. If the private regulatory scheme Chief Judge Fuld envisions is to work, its agents must be rewarded for their efforts." Note, *supra,* 55 VA. L. REV. at 1529-30 (footnote omitted).

The corporate recovery is pure windfall. There is a plain analogy with the liability imposed by §16(b)[26] upon officers, directors, and large shareholders who engage in short-swing trading in their company's stock, and the court in *Diamond* so noted. 24 N.Y.2d at 500.

Diamond suggests two compensatory theories for corporate recovery, but neither will support an award of the defendant's trading profits. Thus the opinion suggests that a corporation may be injured in its "good will" and "reputation", 24 N.Y.2d at 499, but it is recognized that such supposed loss has no relation to trading profits. See Note, *supra,* 11 B. C. IND. & COM. L. REV. at 514 n.80. And the idea that an insider appropriates a corporate "asset" by trading on inside information (24 N.Y.2d at 498), has been dismissed as "makeweight", Note, *supra,* 83 HARV. L. REV. at 1429, since such information has no value to the corporation. The "corporate asset theory", rather, "is a fiction, the purpose of which is to deter and punish conduct deemed undesirable by the court." Note, *supra,* 1970 WIS. L. REV. at 583; see also Note, *supra,* 83 HARV. L. REV. at 1431.

The introduction of this new deterrent device into the law of New York required a decision to sacrifice certain interests in favor of others. Commentators have remarked on the implications of such a decision.

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26. 15 U.S.C. §78p(b).

Diamond may expose a defendant to double liability. He may have to return profits to the corporation in one lawsuit, and he may be held liable to individual purchasers in another lawsuit. Some question this, since "it is difficult to interpret *Diamond* as establishing an injury distinct from that recognized by federal law," Note, *supra,* 83 HARV. L. REV. at 1431, and double liability would therefore be "penal", Note, *supra,* 55 VA. L. REV. at 1533. However, if a setoff of a prior judgment is permitted in a later suit, *Diamond* would compel "a race between the corporation and the victimized party to be first to recover the defendant's booty," Note, *supra,* 45 NOTRE DAME LAW, at 323. Others argue that double liability is fully consistent with the expressed *Diamond* theory:

> "If it is entitled to such a recovery—assuming that the *Diamond* theory is not a facade for some other purpose—then the corporation should not have to share its funds with others, however worthy their claims." Folk, *Corporation Law Developments—1969,* 56 VA. L. REV. 755, 800 (1970) (footnote omitted).

See also, Note, *supra,* 1970 WIS. L. REV. at 585. If so, *Diamond* will not only impose double liability but also will deprive many victims of insider trading of any remedy, for the corporate recovery may wipe out the defendant's assets, rendering a judgment in favor of a purchaser worthless.

Appreciating the injustice of such results, others propose that the corporation's recovery be subordinated to the claims of injured parties. Note, *supra,* 11 B. C. IND. & COM. L. REV. at 514; Note, *supra,* 31 U. PITT. L. REV. at 305. The *Diamond* court so suggests, in stating that the only issue it

decided was, "as between the corporation and the defendants, who has a higher claim to the proceeds," 24 N.Y.2d at 498, and adding that the "fund" might be "subject to a superior claim". *Id.* 504.[27] The prospect that the corporation may have to surrender its recovery makes it obvious that *Diamond* does not "remedy" any wrong to the corporation but rather awards it a conditional windfall:

> "The intimation that the corporation might have to relinquish its recovery to 10b-5 complainants contradicts the court's common law theory for allowing the derivative suit. If the corporation is the beneficiary of a trust, it should not have to share the proceeds from conversion of its property. In addition to exposing the limits of the corporate asset theory, this contradiction demonstrates that the derivative action in *Diamond* was conceived as an expedient alternative born of the inability of buyer and seller remedies to regulate fiduciary access to inside information." Note, *supra,* 55 VA. L. REV. at 1531-32.

Even if the judgment for the corporation will in theory be subordinated to individual claims, further problems arise. Although the *Diamond* court suggested that all such claims could be dealt with in a single interpleader proceeding, it conceded that the purchaser's actions are unwieldy (24 N.Y.2d at 502), and it was apparently unaware that Rule 10b-5 claims could not be tried in state courts because federal courts have exclusive jurisdiction over such claims. 15 U.S.C. §78aa. Thus even if the rights of injured parties could theoretically be protected under *Diamond,* such persons face substantial additional obstacles in securing recovery:

27. Likewise, the court below in this case implied that the defendants should not be exposed to multiple liability (73a).

> "The decision, however, will do little to soothe the troubled area of insider trading. Even if the defendants were to organize a class action against themselves, and manage to obtain jurisdiction of the class in state court, the 10b-5 claim of such third party defendants would appear to be in the wrong forum. Conversely, if the defendants do not bring the purchasers of their stock into state court, will or can the corporation be required to give up any part of its recovery in the derivative action in a later class or individual action by defrauded purchasers in federal court? There are fine questions of jurisdiction and of federal-state relations involved here. If 10b-5 can be used to redress wrongs that ought to be remedied in state courts, perhaps the derivative action can be used to redress wrongs more properly correctible by 10b-5. And if the remarkable expansion of federal securities regulation which has occurred in the past twenty years, and particularly in the last five, was necessary to fill a void in state regulation of the same subject, perhaps the void is now being doubly filled." Bradford, *Rule 10b-5: The Search for a Limiting Doctrine,* 19 BUFFALO L. REV. 205, 215 (1970) (footnote omitted).

The multiple policy problems arising from *Diamond* and its lack of serious theoretical basis have led to sharp criticism of the decision as ill-conceived judicial legislation:

> "However equitably damages might be assessed, the instant holding reflects an unfortunate exercise in judicial creativity. Rendered at a time when the scope of insider liability under existing statutes and agency rulings is at best in a state of flux, the instant decision merely offers the corporate insider greater uncertainty. The court has imposed what amounts to a penalty upon corporate insiders by finding a new common law liability to an undamaged entity for acts

> which existing law, to the extent deemed wise by legislatures, has already provided redress for those actually injured." Note, *supra,* 37 FORDHAM L. REV. at 481.

If New York State, by its legislature or judiciary, reassesses the adequacy of existing doctrines and decides to tolerate obstacles to individual recovery of damages in order to adopt a new deterrent to unfairness by insiders of New York corporations, by means of forfeiture of profits to an undamaged entity in a shareholder's derivative suit, it is fully entitled to do so. As *Diamond* says,

> "The primary source of the law in this area ever remains that of the State which created the corporation." 24 N.Y.2d at 503-04.

But undeniably *Diamond* required such a major policy change[28], such a reassessment of the values of competing interests, and a deliberate decision that shareholders of New York corporations will best be protected from unfairness by management under laws that emphasize deterrence rather than compensation.

No Florida court[29] or legislature has had the opportunity to weigh such considerations, as the New York Court of Appeals did in *Diamond,* and as Congress did in enacting the much more limited §16(b).

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28. *Diamond* has been described as one of a "series of policy-oriented laws and judicial decisions [which] wrought fundamental changes in the relative rights and duties of officers, directors and shareholders, and in the relationship of the corporation to the external world." Schoenbaum, *The Relationship Between Corporate Disclosure and Corporate Responsibility,* 40 FORDHAM L. REV. 565 (1972).

29. A large proportion of Florida's corporate law is still judge-made. See Wright, *Introduction to the Statutory Corporation Law of Florida,* 18 FLA. STAT. ANN. 51, 54 (1956).

Nor did the court below make any such analysis. Despite the novelty of the *Diamond* rule, the substantial criticisms addressed to it, and the lack of any Florida rulings indicating that such a principle might be favored, the *"Schein* court uncritically seized upon *Diamond's* enunciated fiduciary principle as its starting point." Note, 53 B.U.L. REV. 1150, 1152 (1973).

But the court below did not merely subject corporate insiders to this new deterrent, as in *Diamond* and as under §16(b). It went even further, extending liability to persons who had no fiduciary relationship to the corporation and who made no profits, by inferring a "joint venture" that was not even pleaded. To support such a theory, the court cited only antitrust cases involving conspiracies between competitors[30], but such cases are not pertinent in this different context. They concern situations presenting "strong motive for concerted action," *Interstate Circuit, Inc.* v. *United States, supra,* 222, in which competitors engaged in conduct "uniformly beneficial to [them] in protecting their common interests," *American Tobacco Co.* v. *United States, supra,* 793. This context is wholly different, for only the IDS defendants allegedly profited, the other defendants had no "common interest" in assisting IDS, and thus there is no reason to infer any agreement or "common enterprise" (67a).

30. *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946); *Interstate Circuit, Inc.* v. *United States,* 306 U.S. 208 (1939); *Norfolk Monument Co.* v. *Woodlawn Memorial Gardens, Inc.,* 394 U.S. 700 (1969). *Norfolk Monument* is not pertinent, since it only held that "the alleged conspiracy had not been conclusively disproved", *id.* 704, and thus summary judgment was inappropriate.

Most remarkably, the court below alternatively held that all of the defendants automatically became "fiduciaries" on receiving nonpublic information about Lum's, even though they had no connection with the company:

> "The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only to 'technical fiduciaries' but also to others who become 'fiduciaries' through the acquisition of confidential information which is 'owned' by someone else. See *Quinn* v. *Phipps,* [93 Fla. 805, 113 So. 419 (1927)], at 420-21. When the defendants received their 'tip' from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages." (70a).

This concept is wholly new to Florida or any other jurisdiction, and the *Quinn* case that the majority cites does not support it. In *Quinn* the court specifically noted that the defendant solicited the plaintiff's reliance and in turn was relied upon to carry out a transaction for the plaintiff.[31] *Quinn* cannot be used for the proposition that a person who is neither agent, nor employee, nor advisor, nor has any such connection with a corporation becomes a fiduciary simply by receiving nonpublic information.[32] Other Florida

31. "Quinn being a real estate broker, he by that means served notice on the public generally that its confidence was invited if interested in any transaction pertaining to that business. He not only invited Phipps along with the public generally, but solicited his confidence and patronage through McDonald, who brought them together. . . . [H]e knew at the time that Phipps for reasons personal to himself was anxious to secure the property; that he was amply able to purchase it; that he (Quinn) was under an obligation to negotiate for him (Phipps); and that Phipps was relying on him to do so." *Quinn* v. *Phipps, supra,* 113 So. at 442-23.

32. A commentator notes that "it is clear that the shareholders of Lum's reposed no confidence in appellees; likewise the latter accepted no trust from the former. The confidential information aspect of *Quinn* was secondary to the agency relationship. The *Schein* court's use of the case adds nothing concrete as authority." Note, *supra,* 53 B.U.L. REV. at 1153.

cases similarly hold that one is only accountable as a "fiduciary" if, for personal benefit, one violates an obligation undertaken to act in the interest of a principal.[33] Lum's had not engaged Lehman to act for it in any way.[34] The holding that anyone becomes a "fiduciary" by acquiring confidential information simply compounds a fiction in order to impose a windfall recovery.

This new notion goes far beyond *Diamond*[35], which concerns only officers and directors.

> "*Schein* has created, in effect, a new duty owed by outsiders to the corporation. . . . Even though the outsiders do not trade for their own accounts, they will be held jointly and severally liable to the issuer with those who do profit from the use of the information. Even remote, or ultimate, tippees owe the corporation a fiduciary duty." Note, 42 FORDHAM L. REV. 211, 224 (1973).

Thus the likely adverse consequences of *Diamond* will arise in any case alleging unfairness in the purchase or sale of securities of a Florida corporation. The court below has

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33. See, *e.g.*, *Connelly* v. *Special Road & Bridge District No. 5*, 126 So. 794, 797 (Fla. 1930) (employee, trusted to negotiate contracts, violates duty by competing with employer). *United Homes, Inc.* v. *Moss*, 154 So.2d 351, 354 (Fla. App. 1963) (corporate officer and agent conspire to defraud corporation in its purchase of property); *Prescott* v. *Kreher*, 123 So.2d 721, 726 (Fla. App. 1960) (failure to disclose to partners income earned for common benefit).

34. Indeed in the court below the plaintiffs pointed out that "Lehman Brothers was not the investment banker to Lum's and had no legitimate interest in receiving this information." Brief for Appellants 5.

35. Even under New York law a director who connives in a sale of stock on inside information by another insider has no liability where he makes no profits, for *Diamond* itself was dismissed on the pleadings against directors who, like Lehman, gained nothing in the transactions alleged, even though they approved them and took no action to preserve the supposed corporate asset from misappropriation. *Diamond* v. *Oreamuno*, 29 App. Div. 2d 285 (N.Y. App. Div. 1968), *aff'd* 24 N.Y.2d 499, 248 N.E.2d 910 (1969).

decided that in all such cases the public policy of Florida requires the encouragement of this new type of derivative lawsuit, and places a lower priority on recovery by the victims of unfairness.

The motives which tempted the court below to deal so freely with Florida law are not disguised in the opinion. Just as *Diamond* invented a new rule because "the Federal law does not yet provide a really effective remedy," 24 N.Y.2d at 503, the doctrine introduced below is a product of the "perceived need to create a cause of action to supplement the regulation of securities trading based on confidential information." Note, *supra*, 53 B. U. L. Rev, at 1154. The opinion so states:

> "Indeed, though the congressional policy is similar, in some cases where federal private and governmental Rule 10b-5 actions are impractical, 'immunized outsiders' might escape liability altogether except for the availability of this kind of action. . . . In view of the strong desirability of tightening the law of insider trading, we would be remiss indeed if we interpreted *Diamond* as narrowly as defendants would have us to interpret it" (69a-70a).

And at several points the court notes that its novel doctrine was constructed by borrowing concepts developed in federal securities law actions, such as conditional corporate recovery (70a n. 7) and tippor and tippee liability (72a n. 8), and grafting them onto the state law "fiduciary" theory (69a), which does away with the need that the plaintiff be an injured purchaser (65a n. 5).[36] It is

36. See *Haberman* v. *Murchison*, 468 F.2d 1305, 1312 (CA2 1972). Derivative and class action complaints concerning the same allegations as those made here, but brought under the federal securities laws, have been dismissed. *Margoles* v. *Lehman Brothers*, No. 70 Civ. 5355 (SDNY Oct. 22, 1971); *Gregorio* v. *Lum's, Inc.*, No. 71 Civ. 1925 (SDNY July 23, 1971).

clear from the opinion that the court below succumbed to the impulse to "tighten" the law of insider trading and in its enthusiasm to create "a new weapon with which to police trading on the stock exchanges located in New York City," Note, *supra,* 53 B.U.L. REV. at 1159, forgot that it was tampering in depth with the public policy of the State of Florida, which governs this case.

POINT II

In refusing to certify this decisive public policy issue to the Supreme Court of Florida, the court below disregarded the decisions of this Court.

A. The decisions of this Court mandated abstention.

The crucial question in this case clearly calls for a fundamental public policy choice, one which will affect numerous persons with different interests in Florida corporations. Such choice must be made by weighing the merits of such interests, with due regard for the existing framework of Florida corporate law.

This Court's decisions establish that when the state law is uncertain, and the importance of the issue suggests a special need for a correct result, federal courts must abstain from ruling so that a state court can authoritatively decide the issue. By abstaining courts serve public as well as private interests; thus they must consider the need to do so on their own motion. See *Wisconsin* v. *Constantineau,* 400 U.S. 433, 437 (1971); *United Gas Pipe Line Co.* v. *Ideal Cement Co.,* 369 U.S. 134 (1962).

Abstention is required if a state court's construction of a state statute may obviate a constitutional challenge, since such result would prevent needless federal interference with

valid state policies. See, *e.g., Lake Carriers' Association* v. *MacMullan*, 406 U.S. 498, 510-11 (1972); *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941).

Other circumstances present the same prospect that federal courts, misunderstanding state policies, may needlessly interfere with their development, and such circumstances likewise call for abstention. When a federal court is asked to review the application of a regulatory scheme by a state administrative agency, it will usually deny relief, for

> "courts must not substitute their notions of expediency and fairness for those which have guided the agencies to whom the formulation and execution of policy have been entrusted." *Railroad Commission* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573, 581 (1940).

This principle has equal force in a case like this one, where a federal court is asked to assume a policymaking role that properly belongs to a state court. In *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943), this Court again rejected federal review of a state agency's order and stressed in particular the policymaking function which state law assigned to the state reviewing court. That court conducted plenary review and was authorized to propose new regulatory standards; indeed the Court suggested that it might be viewed as having "legislative" authority, *id.*, 325, over the regulated industry. When federal courts assumed that policymaking function, confusion resulted, and the development of the state's regulatory policy was impeded:

> "The very 'confusion' which the Texas legislature and Supreme Court feared might result from review by many state courts of the Railroad Commission's

> orders has resulted from the exercise of federal equity jurisdiction. . . . Delay, misunderstanding of local law, and needless federal conflict with the state policy, are the inevitable product of this double system of review. The most striking example of misunderstanding has come where the federal court has flatly disagreed with the position later taken by a state court as to state law." *Id.*, 327.

Similarly, in *Alabama Public Service Commission* v. *Southern Ry.*, 341 U.S. 341 (1951), this Court ordered abstention in a case attacking a state administrative order. As in *Burford*, the Court emphasized that state courts had been assigned an active, "supervisory", role in review of agency action. *Id.*, 347-48. This rule does not depend on the presence of any constitutional question that might be avoided by statutory construction, for *Burford* and *Alabama* primarily concerned the legality of agency orders under state law. Under these cases, therefore, when state courts have a continuing policymaking role, federal courts will not interfere:

> "The state agency and the state court were characterized in *Burford* as 'working partners,' and in *Alabama* state judicial review was called an 'integral part of the regulatory process.' Present in both opinions is the suggestion that a federal court interfering in this process prior to state review would be forced to determine state policy and thereby would obstruct the state's formulation of its own policy. In *Burford*, the Court cited numerous instances of chaos caused in the state by federal decisions misconstruing state policy." Note, *Judicial Abstention from the Exercise of Federal Jurisdiction*, 59 COLUM. L. REV. 749, 761 (1959) (footnotes omitted).

See also Note, *Abstention: An Exercise in Federalism,* 108 U. PA. L. REV. 226, 231 (1959) (abstention required under *Alabama* and *Burford* "where the decision of the federal courts would involve a determination of state domestic policy or an unnecessary interference with the action of state officials").

Acting consistently with the principle that federal courts ought not to determine sensitive issues of state policy, this Court ordered abstention in *Chicago* v. *Fieldcrest Dairies, Inc., supra,* in order to avoid " 'needless friction with state policies' " and " 'the waste of a tentative decision' " on the impact of possibly conflicting state and city legislation, *id.,* 172, quoting *Railroad Commission* v. *Pullman Co., supra,* 500. The parties were required to secure "an authoritative and controlling determination by the state tribunals," *id.,* before federal relief was available. In *Fieldcrest* the Court specifically stated that any constitutional issues seemed insubstantial and that avoidance of such issues was only an additional reason to abstain. *Id.,* 173.

An additional concern compelling abstention is the need for uniformity in the application of state law. When federal courts came to conflicting conclusions concerning the extent of interests in Illinois land which were granted by certain instruments, this Court ordered that the question be submitted to the Illinois courts lest a later state decision show that "the accident of federal jurisdiction" had led to a result "contrary to the law of the State, which in such matters is supreme." *Thompson* v. *Magnolia Petroleum Co.,* 309 U.S. 478, 484 (1940). Although *Thompson* was a bankruptcy proceeding, its principle is not limited to such cases, see 1A J. Moore, FEDERAL PRACTICE ¶0.203[2], at 2120 (2d ed. 1972), and the Court noted in

Thompson, 309 U.S. at 484n.11, that the principle compelling abstention was derived from *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938).

Subsequent cases illustrate these principles. Concern for uniformity in the application of state law and deference to the state's right to determine its own public policy compelled abstention in *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959). *Thibodaux* was an eminent domain proceeding under diversity jurisdiction. The question arose whether the city was authorized by statute to condemn certain land. For the federal court to decide that issue, the Court held, would risk the unequal application of an important state policy of broad applicability:

> "A Louisiana statute apparently seems to grant such a power. But that statute has never been interpreted, in respect to a situation like that before the judge, by the Louisiana courts and it would not be the first time that the authoritative tribunal has found in a statute less than meets the outsider's eye. Informed local courts may find meaning not discernible to the outsider. The consequences of allowing this to come to pass would be that this case would be the only case in which the Louisiana statute is construed as we would construe it, whereas the rights of all other litigants would be thereafter governed by a decision of the Supreme Court of Louisiana quite different from ours." *Id.*, 30.

The city pressed for a decision on the merits, but this Court reinstated the District Court's stay rather than permit a decision that would be but "a dubious and tentative forecast." *Id.*, 29.

This element of uncertainty in state law was clearly dispositive in *Thibodaux*, for on the same day the Court

ruled, in *County of Allegheny* v. *Frank Mashuda Co.*, 360 U.S. 185 (1959), that abstention was not required in a case that was very similar except that "the state law that the District Court was asked to apply [was] clear and certain." *Id.*, 196. Since the District Court would only be "applying to the facts of this case the settled state policy," *id.*, 190, it was not called upon, as in *Thibodaux* and in this case, to formulate such policy on its own. Mr. Justice Stewart's concurring opinion in *Thibodaux* makes this distinction clear:

> "This case is totally unlike *County of Allegheny* v. *Mashuda Co.;* decided today, post, p. 185, except for the coincidence that both cases involve eminent domain proceedings. In *Mashuda* the Court holds that it was error for the District Court to dismiss the complaint. The Court further holds in that case that, since the controlling state law is clear and only factual issues need be resolved, there is no occasion in the interest of justice to refrain from prompt adjudication." *Louisiana Power & Light Co.* v. *City of Thibodaux, supra,* 31 (concurring opinion).

Thus *Thibodaux's* distinguishing factor was the absence of state precedents:

> "While it may also be possible to distinguish [*Thibodaux* from *Mashuda*] on a narrow procedural ground, the far more significant difference between them consists in the differing conditions of the state law in each, and it appears likely that this 'settled' law factor was in fact controlling." Note, *supra,* 108 U. PA. L. REV. at 244 (footnote omitted).

The concern for uniformity of result in the application of state law is traceable to *Erie R.R.* v. *Tompkins,* 304 U.S. 64 (1938), and indeed the "doctrine of *Erie* may be seen

as a strong generating force of the abstention doctrine itself," Liebenthal, *A Dialogue on England: The England Case, Its Effect on the Abstention Doctrine, and Some Suggested Solutions,* 18 W. Res. L. Rev. 157, 185 (1966). Federal courts, enjoined by this Court to come to the same result as a state court would, have chosen to abstain when faced with a difficult problem of forecasting a state decision. See Note, *Abstention and Certification in Diversity Suits: "Perfection of Means and Confusion of Goals,"* 73 Yale L. J. 850, 855-58 (1964). There is clear authority for such course in *Thibodaux,* where the Court approved abstention

> "to permit an authoritative exposition of an unconstrued state statute and to prevent possible disparity between the federal version of state law and that which would be later fashioned in state court. This expansion of the abstention doctrine was a logical extension of the principle underlying *Erie* that federal courts must defer to state courts for the formulation of state law." Note, *Inter-Jurisdictional Certification: Beyond Abstention Toward Cooperative Judicial Federalism,* 111 U. Pa. L. Rev. 344, 346 (1963) (footnote omitted).

See also Lillich & Mundy, *Federal Court Certification of Doubtful State Law Questions,* 18 U.C.L.A., L.Rev. 888, 889-90 (1971); Note, *Louisiana Power & Light* v. *Thibodaux, The Abstention Doctrine Expanded,* 69 Yale L.J. 643, 651-53 (1960).

And *Thibodaux* clearly requires abstention in a case like this one, concerning an area subject to state regulation, where changes in the law will affect numerous persons, and a fundamental public policy choice must be made:

> "[Q]uestions may be deserving of state determination because they deal with an area of law which is

> undergoing significant development, or because the law of other jurisdictions is in sharp conflict, suggesting the need for a fundamental policy choice. . . . If the federal judge is convinced that the question posed to him is close to a matter of central and continuing state concern, then, he may be justified in invoking the doctrine." Note, *supra,* 73 YALE L.J. at 867.

Both *Thibodaux* and *Mashuda* are fully consistent with the holding in *Meredith* v. *Winter Haven,* 320 U.S. 228 (1943). *Meredith* was a suit brought by municipal bondholders to prevent the city which issued the bonds from retiring them without making certain deferred interest payments. There was a question whether the city had validly assumed such an obligation under state law. The District Court held it had not, following recent rulings of the Supreme Court of Florida. But the Fifth Circuit considered the question difficult, by reason of supposedly conflicting earlier decisions, and ordered dismissal. In this context this Court reversed, stating that

> "the difficulties of ascertaining what the state courts may hereafter determine the state law to be do not in themselves afford a sufficient ground for a federal court to decline to exercise its jurisdiction . . . ." *Id.,* 234.

Meredith holds only that a federal court's doubts whether controlling state decisions will stand do not support abstention. Thus it resembles *Mashuda* and does not concern a case like this one or *Thibodaux,* where no direct precedents exist:

> "The third point of difference, and perhaps the most important, between *Meredith* and *Thibodaux* is that in the former, after the suit was begun, a state

> decision apparently decided the precise issue presented to the district court, and the Fifth Circuit founded its relegation to the state tribunal on its belief that the state court might at some *future time* set aside that state decision. . . . *Thibodaux*, however, did not involve the refined element of fear that what presently was state law might be changed; rather it involved a serious question of state authority, an authoritative determination of which would control the outcome of the litigation." Gowan & Izlar, *Federal Court Abstention in Diversity of Citizenship Litigation*, 43 TEXAS L. REV. 194, 204-05 (1964) (italics original; footnotes omitted).

In *Thibodaux* there was more than supposed "confusion in state decisional law"; rather there was "a complete absence of state decisional law," Note, *Federal Abstention and its Relation to the Erie Doctrine*, 38 TEMP. L.Q. 72, 77 (1964). The difficulty of the case was not in the legal analysis required but in the policy judgments to be made, and abstention therefore was ordered.

The principle of *Thibodaux* does not depend on the nature of eminent domain proceedings, for "the view that eminent domain expropriations are 'special and peculiar' suits at law for federal abstention purposes was rejected by a majority of the Court" in *Mashuda*. Note, *supra*, 69 YALE L. J. at 650. Nor does it turn on the presence of a state agency as a party, for in *Thibodaux* that factor was put out of the case when the city whose powers were in question urged a decision by the federal court. Commentators have doubted that the extent to which a case concerns the powers of a state agency is material to the *Thibodaux* principle, since

> "it is questionable whether the city's condemnation of property involved in *Thibodaux* was any more

> closely related to local sovereignty or any more sensitive as a subject of federal-state conflict than the city's program for retiring its bonded indebtedness in *Meredith.*'' Note, *supra,* 59 COLUM. L. REV. at 764.

This Court recently emphasized the need to abstain in another diversity case, where the federal courts were asked to decide an important issue of state public policy. In *Kaiser Steel Corp.* v. *W.S. Ranch Co.,* 391 U.S. 593 (1968), the Court reversed the action of two lower courts and ordered abstention pending a state decision. No state agency was a party to the case. A landowner sued, claiming that a mining company had taken its land to lay a pipeline to carry water to its mining operations. The mining company asserted that it had the right to do so under a New Mexico statute, which gives any person the right to take land, as by eminent domain, to convey water for "beneficial uses."[37] The landowner maintained that the State constitution, which permitted only takings for "public use"[38], included agricultural uses but not private industry. The Court of Appeals found caselaw on related issues[39] but no decision on takings for access to water. It held the taking unlawful, based on the available precedents, *W.S. Ranch Co.* v. *Kaiser Steel Corp.,* 388 F.2d 257 (CA10 1967).

Thereafter the mining company filed a state declaratory judgment action and sought rehearing, asking the Court of Appeals to abstain. The majority summarily refused,

37. N.M. STAT. ANN. §75:1-3 (1953).

38. N.M. CONST. art. II, §20.

39. The Supreme Court of New Mexico had invalidated an earlier statute which authorized takings of land in aid of mining operations, on the ground that such operations were not a "public use". *Gallup American Coal Co.* v. *Gallup Southwestern Coal Co.,* 39 N.M. 344, 47 P.2d 414 (1935).

but Judge Brown dissented, urging that *Meredith* v. *Winter Haven, supra,* did not require federal courts to speculate unnecessarily on important state law issues:

> "Thus, *Meredith* v. *City of Winter Haven,* [*supra*], is not, as so often supposed, an absolute that under every and all circumstances a federal court in a diversity case has to plow through without calling on the state tribunals for aid in the divination of serious and troublesome state problems. Too much has gone on—indeed too much water has gone over the dam—for any such reading to be compelled. Putting to one side *Thibodaux,* in which the Court of Appeals was reversed for failure to abstain for state court determination in a diversity case, the Supreme Court's repeated use of the Florida *Clay* type certification procedure demonstrates that the policy reflected in *Winter Haven* is not a road block. It is simply one of the factors to be assayed." *W.S. Ranch Co.* v. *Kaiser Steel Corp., supra,* 388 F.2d at 263-64 (concurring and dissenting opinion; footnotes omitted).

Continuing, Judge Brown pointed out that the federal courts' rulings on state law were often overruled and that refusing to abstain in an important case not only was unfair to litigants but also needlessly interfered with the development of the state's public policy:

> "[R]eal injustice is done to litigants and, worse, more damage is done to the states' jurisprudence and its policies by a headstrong, resolute, inflexible determination on the part of a federal court to barge ahead in a sort of ascetic, misguided *Winter Haven* impulse, than will likely result from the slight delay occasioned by invoking state adjudication of the controlling issues. For the simple fact is that more and more, more federal courts are being overruled by more state courts on local issues upon which

> such federal courts have undertaken to read the *Erie* signs in the quest of the *Winter Haven* grail." *Id.*, 264 (footnote omitted).

Notably, he singled out the experience with Florida law as a particular example of the inaccuracy of federal "predictions":

> "And the experience in Florida demonstrates that state court reversals of Federal appellate decisions occur both in appeals of state cases and on *Clay* certification . . . to the Supreme Court of Florida, the latter with some spectacular results." *Id.*, 265 (footnotes omitted).

The results in Florida led him to the frank conclusion that

> "No amount of prescience, including that thought by some to come from a Federal Commission, enables a non-Florida Judge authoritatively to determine Florida policy." *Id.*, 265 n.15.

Judge Brown considered the argument that, having taken the land by self-help and invited a diversity suit, rather than using New Mexico's condemnation procedure, the mining company might well be admonished to accept the result of that suit, however doubtful. But he stressed again that his main concern was damage to "the State and its carefully nurtured, domestically contrived public policy". *Id.*, 266. Since the unguided federal ruling was "authoritative" only for one case, its only justification could be avoidance of delay. But the law does not normally strive for speedy but dubious results, nor does it favor the perpetuation of uncertainty in legal rules. Where the issue was bound to arise again soon, Judge Brown saw no point in such a ruling:

> "In the look back—even in the eyes of the pedagogical jurists—about the only virtue it will have is that someone did his duty in the *Winter Haven* sense. In the meantime, of course, Kaiser and Ranch know their rights. But no one else, and certainly not New Mexico, knows. Nor will they until New Mexico speaks. Why not listen?" *Id.*, 267 (footnote omitted).

This Court granted the mining company's petition for certiorari and unanimously reversed without argument, adopting the course urged by Judge Brown and ordering a stay of the case pending decision of the state law issue in the declaratory judgment action. The issue between the parties, the Court stated, "is one of vital concern in the arid State of New Mexico, where water is one of the most valuable natural resources." *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra*, 391 U.S. at 594. Thus the decision would necessarily affect numerous New Mexico businesses and landowners—absent parties whose interests would only be represented by the considered judgment of the New Mexico courts. The issue, moreover, was unsettled and destined to recur. Uniformity of result, fairness to the parties, and the efficient protection of state-created rights in federal courts required abstention, so that the state courts could determine New Mexico's public policy:

> "The issue, moreover, is a truly novel one. The question will eventually have to be resolved by the New Mexico courts, and since a declaratory judgment action is actually pending there, in all likelihood that resolution will be forthcoming soon. Sound judicial administration requires that the parties in this case be given the benefit of the same rule of law which will apply to all other businesses and landowners concerned with the use of this vital state resource." *Id.*, 594.

Three Justices concurred separately in an opinion by Mr. Justice Brennan, who reaffirmed the position he took in dissent in *Thibodaux,* where he approved use of abstention to prevent needless friction with state policies, 360 U.S. at 33, and pointed out that the circumstances of the case came within *Alabama Public Service Commission* v. *Southern Ry., supra,* and *Burford* v. *Sun Oil Co., supra,* where the Court had refused to permit federal courts to undertake a pure policymaking function in deciding points of state law. The reliance on *Alabama* and *Burford* demonstrates that the principle of those decisions is not confined to review of administrative action, nor is it limited to suits involving state officials; rather it has equal force whenever a recurrent and important policy question must be decided by the state courts, as in *Kaiser* and this case.

Confirming the doubts of the dissenting circuit judge in *Kaiser Steel,* after this Court ruled, the state court decided the declaratory judgment suit, holding that the state law was exactly contrary to The Tenth Circuit's view, *Kaiser Steel Corp.* v. *W. S. Ranch Co.,* 81 N.M. 414, 467 P.2d 986 (1970). Thus a serious injustice was avoided, and the frustration of the state's public policy was prevented.

Some have suggested that this Court should defer to the lower court's exercise of discretion whether to abstain, see Wright, *supra,* 37 Texas L. Rev. at 825; Note, *supra,* 108 U. Pa. L. Rev. at 248, and that such deference explains the ruling in *Thibodaux.* In this case there has been no exercise of discretion to which the Court may defer. The court below completely failed to explain why it would not abstain or certify the issue, even when urged to do so by Judge Kaufman in dissent. Such summary action calls for no deference. *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* so holds.

Just as in the *Kaiser* case the issue here is strictly one of Florida's public policy. Moreover, whatever rule is eventually established will affect every Florida corporation, its shareholders, and management personnel. This issue is destined to recur; indeed, the new rule announced by the court below is intended to spur litigation. *"Schein* should spawn a new breed of inside information cases," Note, *supra,* 42 FORDHAM L. REV. at 223, and such suits will necessarily affect actions to recover actual damages. The doctrine established in this case is only provisional and can stand only until Florida can speak authoritatively through its Supreme Court, yet it will establish, unless reversed, the liabilities of the parties to this case. Fairness to the parties, uniformity of result, and concern for the freedom of Florida to develop its own public policy called for abstention in this case.

B. Certification Accomplishes the Purposes of Abstention But Presents None of Its Practical Problems.

1. Certification provides a simpler solution.

The only alternatives here were not to abstain or to guess what the law of Florida was. There was a third way to determine the Florida law, simpler than either such method. The crucial issue could have been certified direct to the Supreme Court of Florida. Under this procedure the federal court states the issue of law and its factual background in a certificate to the Florida court.[40] The

40. For examples of such certificates, *see, e.g. Gordon* v. *John Deere Co.,* 451 F.2d 234, 235 (CA 5 1971); *National Educ. Ass'n* v. *Lee County Bd. of Pub. Instruction,* 448 F.2d 451, 452 (CA 5 1971); *Allen* v. *Estate of Carman,* 446 F.2d 1276, 1277 (CA 5 1971); *Boyd* v. *Bowman,* 443 F.2d 848, 850 (CA 5 1971). It is the "experience-born practice," *Allen* v. *Estate of Carman, supra,* 1277, of the Fifth Circuit to request the parties to submit a proposed agreed certificate for review by the court.

parties to the federal case brief and argue[41] the point, and the Florida court transmits its answer to the federal court. Certification of questions direct between state and federal courts is "a third method . . . for determining unresolved issues of state law." Note, *The Uniform Certification of Questions of Law Act*, 55 IOWA L. REV. 465, 470 (1969).

Interjurisdictional certification in the United States is a recent development, but the principle is not new. Since 1859 there has been a statutory procedure for certification of questions of law among British dominions, British Law Ascertainment Act of 1859, 22 & 23 Vict. c. 63; 9 *Halsbury's Statutes of England* (2d ed.) 582. In this country numerous states authorize their lower courts to certify questions to appellate courts within the same system. See Vestal, *The Certified Question of Law*, 36 IOWA L. REV. 629, 632-33 (1951). Within the federal system a district court may certify a "controlling question of law as to which there is substantial ground for difference of opinion," 28 U.S.C. §1292(b) to a court of appeals for decision. Likewise a court of appeals may certify to this Court "any question of law . . . as to which instructions are desired," 28 U.S.C. §1254(3).[42]

Certification preserves an active role for the federal court, unlike abstention, for rather than merely remitting the parties to a state court, the federal court states the legal issue to be decided and specifies its factual context:

> "[T]he federal court would not be reduced, in a diversity case, to a 'sterile monitor,' for it would

41. A sixty-day briefing schedule is fixed by rule of court, and argument may be permitted on application; FLA. APP. RULES, R.4.61(g), (h) (1967).

42. *See, e.g., United States* v. *Barnett*, 376 U.S. 681, 689-90 n. 6 (1964); Moore & Vestal, *Present and Potential Role of Certification in Federal Appellate Procedure*, 35 VA. L. REV. 1 (1949).

> be the basic instrument of the resolution of the entire case in specifying the state law question within the framework of the relevant facts and legal issues to the state's highest authority." Liebenthal, *supra*, 18 W. Res. L. Rev. at 201 (footnote omitted).

Because the federal court frames a specific question of law and retains all other parts of the case, the procedure differs in principle from abstention:

> "It would not seem . . . that the certification procedure is in effect a variation of abstention. . . The federal courts by taking advantage of a certification procedure do not abnegate their responsibility to decide a diversity case. . . .
>
> "The certification procedure is analogous to a situation in which a federal court temporarily abstains because another case between different parties involving precisely the same issues of state law is pending in the state appellate courts. Certainly this would be proper in a diversity case. . . ." Gowen & Izlar, *supra*, 43 Texas L. Rev. at 209-10 (footnote omitted).

Abstention may cause practical and jurisdictional difficulties, and the independent predictions of federal judges produce uncertainty and unfairness; certification has been developed as a solution.

2. The drawbacks of Erie-guesswork and absention.

Under this Court's decisions, federal courts faced with state law questions must "search for and apply the entire body of substantive law governing an identical action in the state courts," *Ruhlin* v. *New York Life Insurance Co.*, 304 U.S. 202, 209 (1938), and "ascertain from all the available data what the state law is and apply it," *West* v.

American Telephone and Telegraph Co., 311 U.S. 223, 237 (1940). For a federal judge, operating independently, to adhere to these standards can be extremely burdensome. Circuit Judge Wright, whose decision to abstain in *Thibodaux* was affirmed by this Court, has explained the awkwardness of the *Erie* role:

> "This awkwardness is easily demonstrated. First, the process of deciding cases under Erie is laborious, often onerously so, at least when state law on the point at issue is less than immaculately clear. Our mandate from *Erie* is to find out how the state high court would decide the issue today. In making that prediction, the federal judge exhaustively analyzes all the state court cases even remotely in point. While federal courts are not necessarily bound by lower state court rulings, or by the dicta and ancient holdings of the state high court, our practice, born of fear of federal-court law-making, is to defer to them far more generously than the state high court itself probably would." Wright, *The Federal Courts and the Nature and Quality of State Law*, 13 WAYNE L. REV. 317, 321 (1967) (footnotes omitted).

Since the task is to predict a decision rather than to make one, the federal court must sift through any materials that might influence a state court:

> "Nor is our inquiry ended simply by consulting the state cases. The *Erie* court must search out all the legal materials—law review articles, the treatises on the subject, and the cases from other jurisdictions—which might impress and influence the state high court in deciding the issue today. We should not be surprised, then, that *Erie*-opinions are laced with paragraph-long statements of the facts of conceivable precedents, and with long string citations representative of what one commentator calls the 'legal-massive' style of legal writing.

> "It has even been contended that *Erie* obliges the federal court somehow to intuit underlying themes or messages of the state's jurisprudence, and to elicit by induction from reported cases the decision-making techniques of the highest state court: for example, its implicit attitude toward *stare decisis*. Meeting these responsibilities would surely foster more accurate predictions. But they would also require the federal court to digest and master the entire corpus of state law; my fear is that we on the federal bench lack the acuity, leisure, and stamina for undertaking these intellectual ordeals." *Id.*, 321-22 (footnotes omitted).

See also Note, *Federal Interpretation of State Law—An Argument for Expanded Scope of Inquiry*, 53 MINN. L. REV. 806 (1969).

Some such efforts are justified by their results, but in *Erie* cases that can never be so. For the decision settles nothing except the immediate dispute between the parties. For other persons the law is still unclear; thus the federal ruling only prolongs legal uncertainty, risks inequity, and encourages forum shopping. Florida itself has suffered from such effects:

> "[T]he Florida-federal relationship has presented a vivid illustration of the uncertainty created by lame federal court decisions. The obvious result is an inequitable application of the law and a return to forum shopping, which *Erie* sought to avoid." Note, *Florida's Interjurisdictional Certification: A Reexamination to Promote Expanded National Use*, 22 U. FLA. L. REV. 21, 24 (1969) (footnotes omitted).

Nor can the inefficiency of such practice be ignored. The tentative federal decision forms no part of the state's body of precedents. Not until a similar suit arises in the state

system and the state courts decide it can an uncertain point be settled. See Wright, *supra*, 13 WAYNE L. REV. at 322-24. Since the federal court's effort achieves so little, it is plainly a waste of valuable judicial resources which begs for a solution.

Abstention, on the other hand, achieves uniformity of result and an authoritative precedent in the first litigated case; in addition it entails no sacrifice of the state's right to formulate its public policy through the organs of its own government. Yet there is a cost to the litigants. In certain cases a party may lose his right to have issues of law or fact determined by a federal court. See *England* v. *Louisiana State Board of Medical Examiners*, 375 U.S. 411, 416-19 (1964). The time and expense of the additional trial and appeal required under abstention may detract from the eventual result. See *Baggett* v. *Bullitt*, 377 U.S. 360, 379 (1964); *County of Allegheny* v. *Frank Mashuda Co.*, *supra*, 196.

3. Certification solves such problems.

The Florida certification procedure was "designed to alleviate the problems created by the *Erie* decision and abstention in our federal system." Note, *supra*, 22 U.FLA. L. REV. at 27 (footnote omitted). A Florida writer states that the certification statute may be viewed as the state's response to the apparent restrictions which this Court placed on the availability of abstention in *Meredith* v. *Winter Haven*, *supra*:

> "The enabling act was probably a reaction to the decision of the United States Supreme Court in *Meredith* v. *Winter Haven*, where the Court noted the evils of abstention and refused to abstain, deciding an issue of municipal powers in Florida without the benefit of a Florida pronouncement of the law." *Id.*, 27-28 (footnote omitted).

In enacting a certification statute, Florida's Legislature affirmatively declared its desire to have the Supreme Court of Florida resolve state law problems, even those arising under federal jurisdiction. Such an expressed state policy is due special weight in determining whether a matter should be referred to the state courts. *Alabama Public Service Commission* v. *Southern Ry., supra,* 348; *Burford* v. *Sun Oil Co., supra,* 325-27.

Since Florida adopted certification, the federal and state court systems no longer operate in watertight compartments. In fact, the system truly enables a federal district judge to act as just another court of the state, "for he will know his decision is subject to review in the highest state court through use of the certification procedure by the appellate court." Liebenthal, *supra,* 18 W. Res. L. Rev. at 205.

Certification will enable a federal district judge to play a more active role in the development of the state's jurisprudence, for he need not fear that his ruling will produce disuniformity in state law or interfere with policies that the state supreme court seeks to promote. Moreover, through certification, federal cases will contribute to the state's body of precedents and thus advance rather than retard the development of state law.

If certification is available, the court of appeals is not required to undertake an extensive investigation for binding precedents, in an effort conscientiously to comply with *Erie*:

> "In the Diogenes-like search for 'state law', the federal courts have resorted to the decisions of interappellate courts and even the decisions of the nisi prius courts. Quite obviously such decisions

> may be questionable, ill-considered and possibly may not represent the 'state law.' The solution offered by the Florida legislation would obviate resorting to unauthoritative sources to determine the law of a state, and would solve the problem of the search for controlling precedents when none, in fact, exists." Vestal, *supra*, 36 IOWA L. REV. at 644-45 (footnotes omitted).

The availability of such review will conclusively eliminate the inequities which *Erie R.R.* v. *Tompkins*, *supra*, sought to prevent. Professor Kurland states that certification offers the "greatest promise" of insuring that litigants receive their *Erie* right to equal application of state law:

> "The fourth possibility, offering the greatest promise, is to have the federal intermediate appellate court certify the troublesome question of state law to the state high court for resolution. . . . In this manner, the court best equipped to answer the state law questions could do so in a definitive manner, without the expense of time and resources demanded by a stay of the federal court proceeding pending a declaratory judgment action in the state court. . . . [T]he equality of treatment which the *Erie* rule was aimed to accomplish would be better assured." Kurland, *Mr. Justice Frankfurter, The Supreme Court and the Erie Doctrine in Diversity Cases*, 67 YALE L.J. 187, 214 (1957) (footnote omitted).

See also Note, *Consequences of Abstention by a Federal Court*, 73 HARV. L. REV. 1358, 1368 (1960).

In addition, once the state court determines the issue of state law, the court of appeals and this Court will not be confronted with that issue on appeal or certiorari. "No appeal based solely on the inaccuracy of the federal court's determination of state law is then possible, since the state's binding answer is incorporated into the federal court's decision." Note, *The Uniform Certification of Questions of Law Act,* 55 IOWA L. REV. 465, 472 (1969). At every level there is a clear gain for the efficient administration of justice.

Certification also answers any objections to the abstention doctrine. The Florida procedure has been described as "[p]robably the best solution to the delay problem," Kurland, *Toward a Co-operative Judicial Federalism: The Federal Court Abstention Doctrine,* 24 F.R.D. 481, 489 (1960). Under this expeditious procedure it cannot be said that litigants must undergo two lawsuits to gain relief:

> "If instead of abstaining, a federal court can certify the state law question—in its factual setting and in the context of any constitutional objections—directly to the state's highest court and under an expedited procedure, the litigants will be saved the time and expense of proceeding through the lower state court system, subject to trial and appellate court docket delays. Indeed, Mr. Justice Holmes referred to certification as 'a mode of disposing of cases in the least cumbersome and most expeditious way.'" Note, *supra,* 111 U. PA. L. REV. at 348 (footnote omitted).

It took two years and five months to secure a decision by the state supreme court in *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* after the Tenth Circuit initially denied abstention, during which time the defendant stayed in pos-

session of the plaintiff's land as an alleged trespasser. Abstention was clearly required there, but commentators have since concluded that "[h]ad there been a certification procedure available to the court of appeals, it is extremely unlikely that it would have taken as long to get an answer from the New Mexico courts." Lillich & Mundy, *Federal Court Certification of Doubtful State Law Questions*, 18 U.C.L.A. L. Rev. 888, 909 (1971). A recent study, Note, *The Case for Certification*, 12 Wm. & Mary L. Rev. 627 (1971), bears out Florida's record of promptness in answering certified questions, which can fairly be compared with the fifteen months required to decide the appeal in this case.[43]

In any event, concern over delay can have little weight in this case, since the plaintiffs do not sue for their own benefit but only for the corporation, which has not even sued, and any recovery in its behalf would be a sheer windfall bonus.

Certification fully preserves the benefits of diversity jurisdiction. To the extent that diversity jurisdiction is still needed to guard against bias or influence in local courts, such needs are primarily met by a federal forum for trial, which is not affected under Florida's certification system. Note, *supra*, 73 Yale L.J. at 858-861; 868-69. When a federal court abstains and remits an issue for trial by state courts, the right to a federal trial of the pertinent facts is lost.

> "Remission is therefore quite different from the widely advocated procedure, which is provided by statute in one state, of certifying an issue from

43. The notice of appeal in this case was filed on February 4, 1972. The record was docketed on April 5, 1972. Briefing was completed on October 3, 1972. The Court of Appeals decision came down on May 10, 1973.

> federal court to the highest state court. Under that procedure, only the certified issue of law would be decided by the state court, and only on the record, in an attempt to avoid disputes over facts." Note, *supra,* 69 YALE L.J. at 654 (footnotes omitted).

See also Note, *Federal Jurisdiction-Abstention-Inter-Sovereign Certification,* 48 IOWA L. REV. 185, 192 (1962). Under certification only the issue of law is referred to the state court, and the right to a federal forum is preserved.

> "The role of the state court would be to simply declare 'authoritatively' what the state law is. It is not doubted that under *Erie* a federal court must follow state law as the rule of decision. Save for considerations of cost and delay which abstention may add to a litigation, it may well be thought that it is irrelevant to the litigants that the judges may ascertain state law by one process or another—by consulting with their law clerks or by abstaining in favor of their state counterparts." Note, *supra,* 73 YALE L.J. at 862.

See also Note, *supra,* 38 TEMP. L. Q. at 82. Thus the only role which the federal court relinquishes is the law-making role, which belongs to the state courts in any event:

> "[D]iversity jurisdiction is intended to create only an alternative forum to ensure evenhanded application of state law and unbiased fact finding—by definition not involved in certification since the certificate establishes the factual situation—, rather than to provide a means of avoiding state court interpretation of state law." Note, *supra,* 111 U. PA. L. REV. at 359.

Specifically, under certification the evidence will be assembled by the use of federal discovery procedure and admitted under liberal federal standards, and the facts will be

found by a jury chosen according to federal standards or by an Article III judge. The rights of a diversity plaintiff are not abridged in any way:

> "Although a certification procedure is used, it is in the federal court that the fact determinations are made, and it is in there that the law derived from the state court in its certified answer will be applied. Therefore, the diversity plaintiff has received all to which he is entitled." Gowen & Izlar, *supra,* 47 TEXAS L. REV. at 210.

There is no real chance that a state supreme court will distort its answer to the certified question in order to prejudice an out-of-state litigant, since its opinion on certification constitutes a precedent affecting all the citizens of the state. See Gowen & Izlar, *supra,* 43 TEXAS L. REV. at 209-10; Liebenthal, *supra,* 18 W. RES. L. REV. at 180. In this context the refusal to permit Florida to decide an important issue of its own law "reflects something of a provincial attitude regarding the fairness of other tribunals." See *The Bremen* v. *Zapata Off-Shore Co.,* 407 U.S. 1, 12 (1972). Here, anyway, the plaintiffs cannot urge, against certification, the policy of diversity jurisdiction of protecting out-of-state litigants, since the interest they represent is a Florida corporation.

Under abstention, difficult *res judicata* questions may arise in a case raising more than a single state law issue. It may be argued that the state court decided other issues and that the plaintiff is bound by such decision on his return to federal court. See, *e.g., England* v. *Louisiana State Board of Medical Examiners,* 375 U.S. 411 (1964); See Note, *supra,* 73 HARV. L. REV. at 1365-68. But such problems do not arise when certification is used:

> "By certifying questions to the state court, the federal court would be in a position to control what

> issues are presented to the state court, reserving to itself the factual determinations and the ultimate resolution of the federal claims. This result would seem to comply with the rule laid down by the Supreme Court in *England*." Lillich & Mundy, *supra*, 18 U.C.L.A. L. REV. at 906 (footnote omitted).

Thus questions will not later arise over what issues the parties litigated in the state court. Note, *Certifying Questions to State Supreme Courts as a Remedy to the Abstention Doctrine*, 9 S. DAK. L. REV. 158, 170 (1964). The Florida court, moreover, has taken care to confine its rulings to the question certified. See, *e.g.*, *National Education Association* v. *Lee County Board of Public Instruction*, 260 So. 2d 206, 210 (Fla. 1972) (federal constitutional issue noted but not ruled upon).

Nor can it be said that a certified question will be too abstract to present the issue fairly. Certificates from the Fifth Circuit to the Supreme Court of Florida normally include a full statement of facts found or alleged, which is drafted by the parties and reviewed by the court before transmittal.[44] The Florida court may require the record to be sent as well.[45] On such basis the question is no more "abstract" than any other issue on appeal, and it can be answered with precision. See Liebenthal, *supra*, 18 W. RES. L. REV. at 202-03.

Since certification provides a positive answer and a state-law precedent instead of a tentative federal forecast, but does so without the practical problems of abstention, it has been greeted as "a better answer" to the problem of determining state law without sacrifice of federal interests:

> "But a better answer seems to be that there is a device which fulfills the needs of our dual system

44. See note 40, *supra*.

45. FLA. APP. RULES, R.4.61(e) (1967), set forth at p. 4, *supra*.

> of government, avoids the problems of scope of state-court action and of res judicata, and affords the parties a quicker decision. The device is inter-jurisdictional certification." Note, *supra*, 73 HARV. L. REV. at 1368.

This writer concludes that certification, "apparently conceived as an aid to the federal courts' discharge of their obligation, under the rule of *Erie R.R.* v. *Tompkins*, to follow state law in diversity cases," should be used by federal courts which find themselves in "situations of genuine perplexity concerning state law." *Id.* Since certification is considered "the most workable cure for the infirmities of the abstention doctrine," Note, *supra*, 38 TEMP. L. Q. at 84, commentators advocate its use even when abstention might not be appropriate:

> "Since at the appellate level the principal cost of abstention is in expense and delay to litigants, the federal court could properly be far more liberal in abstaining where, in the particular case, these factors were demonstrably unimportant, or likely to be held in check by the procedures available in state courts. . . . The Florida certification device, on the other hand, allows litigants to skirt the lower state courts entirely and to obtain a judgment directly from the highest state court in answer to propounded questions of state law, a procedure which may result in considerable savings of time and expense. . . . Given the speed, authority and economy possible using certification procedures, abstention under these procedures could tolerably range a far wider scale of state law questions than abstention implemented by declaratory judgment." Note, *supra*, 73 YALE L. J. at 867-69 (footnotes omitted).

See also Liebenthal, *supra*, 18 W. RES. L. REV. at 201.

4. Certification promotes cooperative judicial federalism.

It must be recognized that techniques such as abstention and certification also serve public interests as a "mecha-

nism for allocating kinds of cases and kinds of issues to state and federal courts," Hofstedler, *Comity and The Constitution: The Changing Roles of the Federal Judiciary*, 47 N.Y.U.L. Rev. 841, 867 (1972). Whether to refer an issue to the state system cannot properly be decided without giving consideration to the most efficient use of judicial resources of both systems. Indeed any concept of comity must include such a concern. Thus for Professor Kurland the Court's 1959 abstention rulings[46] raise two issues of "cooperative judicial federalism":

> "The first is how to utilize the special expertise of each of two judicial systems, State and federal. The second is how to economize on the use of the systems so that one lawsuit will suffice to dispose of the problem rather than permitting two with the possibility of conflicting results as well as multiple costs." Kurland, *supra*, 24 F.R.D. at 487.

As a possible solution to such problems, Professor Kurland explicitly endorsed Florida's certification system. *Id.*, 489-90. Others concur. Deploring the "misallocation of judicial resources" that occurs when a federal court must make an *Erie*-prediction on a complex state law question, Judge Wright has specifically urged certification as a solution.

> "A far more ingenious escape from *Erie's* troubles is the certification procedure. This happens when a federal *appellate* court 'certifies' or remands a troubling question of state law involved in an *Erie* suit to the state *high* court for its resolution. Since certification does not forfeit the parties' rights to all the advantages of a federal trial, it conceivably encompasses the best of all possible worlds." Wright, *supra*, 13 Wayne L. Rev. at 325 (footnote omitted).

46. *Martin* v. *Creasy*, 360 U.S. 219 (1959); *County of Allegheny* v. *Frank Mashuda Co.*, 360 U.S. 185 (1959); *Harrison* v. *N.A.A.C.P.*, 360 U.S. 167 (1959); *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959).

State judges also find merit in certification. Justice Samuel J. Roberts of the Supreme Court of Pennsylvania has enthusiastically endorsed certification as the most progressive proposal for cooperation between state and federal courts.

> "[M]y general thesis, that keeping the door between the courtrooms open not only will minimize the friction between federal and state judiciaries, but also will result in more equal treatment of litigants, has just as much vitality in non-constitutional, non-criminal areas. Easily the most significant step yet taken toward establishing a uniform interpretation of *state* law by federal and state courts has been Florida's unique certification procedure. . . .
>
> "Since the initial decision to employ Florida's statute rests with the federal appellate court, the certification procedure clearly can be only as effective as the federal judiciary chooses to make it. . . . Although I believe that the certification procedure should not be invoked indiscriminately, certainly when a previously undecided state question of significant import finds its way into the federal system, certification to the state court will preserve the integrity of local law and forestall a possible conflict with later state decisions." Roberts, *A State Judge Looks at the Federal Courts*, 116 U. Pa. L. Rev. 468, 476 (1968) (italics original).

The Supreme Court of Florida itself welcomes the opportunity to cooperate with federal courts by expounding principles of Florida law:

> "We appreciate the courtesy of the Supreme Court of the United States in allowing this court to participate in the settling of an important principle of *state* jurisprudence." *Aldrich* v. *Aldrich*, 163 So. 2d 276, 277 (Fla. 1964).

Independent *Erie*-prediction and abstention are premised on the necessity for eternal separation between state and federal judicial systems. Certification, in contrast, enables cooperation between those systems, so that each can perform its function more fully:

> "Thus, inter-jurisdictional certification, as illustrated by the *Clay* case, not only achieves the objectives of abstention—to prevent federal invasion of the state lawmaking function and to avoid needless federal-state friction—, but also represents a more perfect attempt at cooperative judicial federalism, since concern for state sovereignty is implemented through a more efficient and simpler proceeding. In addition, by abstaining, a federal court temporarily—if it has stayed the action—or permanently—if it has dismissed the action—severs itself from the case, leaving the state court to make an independent determination of at least the state law issue. Judicial cooperation exists only in the sense that a federal court has deferred to a state court. In inter-jurisdictional certification, however, the federal court actively participates in the resolution of the entire case by framing the state law question, specifying relevant facts and legal issues, and certifying directly to the state's highest court." Note, *supra*, 111 U. PA. L. REV. at 350.

5. There is a consensus that certification accords with modern principles of judicial administration.

The National Conference of Commissioners on Uniform State Laws has recommended, and the American Bar Association has approved, a proposed Uniform Act for the certification of questions of law between state and federal

courts.[47] The accompanying note states that certification provides a solution to the "very difficult problem", arising from *Erie*, of ascertaining state law when there are no precedents in point: "The federal courts have been forced

47. UNIFORM CERTIFICATION OF QUESTIONS OF LAW [ACT] [RULE], HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 147 (1967), approved and recommended for enactment in all the states by the National Conference of Commissioners on Uniform State Laws, in its conference of July 31 through August 5, 1967, and approved by the American Bar Association at its meeting of August 9, 1967. 53 A.B.A.J. 976 (1967). The accommpanying note states, in part:

"Reasons for Proposed Uniform Act

"Since the announcement in *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938) that federal courts in non-federal matters would be required to follow state law rather than some general common law, the federal courts have been faced with a very difficult problem. This is the ascertainment of state law when the state judiciary has not spoken definitively on the matter. The federal courts have been forced to guess what the state law is. To avoid this awkward situation the federal courts have developed an abstention doctrine under which the federal courts refrain from acting while the litigants turn to the state court to get the definitive statement of the local law. This device has proved to be quite unsatisfactory. See 1A *Moore's Federal Practice* ¶0.203.

"In the search for a suitable technique to assist the federal courts in ascertaining the law of the state, the certified question is now being used. The certifying federal court sends to the state's highest court the question to be answered. The question is considered and the answer given. This is a more rapid method than the use of the abstention doctrine and seems to be a much more orderly way of handling the problem. Within recent years, a group of states have provided for the certification of questions of state law from federal courts to the highest court of the state. The first to provide for such certification was Florida, Florida Stat. Ann., Sec. 25.031. The device has been used with some frequency since its adoption. . . . Although the Court of Appeals for the Fifth Circuit may decide that a question of Florida law is not subject to doubt, it apparently considers the possibility of certification to the Supreme Court of Florida as part of its normal approach to problems of Florida law. . . ." *Id.*, 147-48 (footnotes omitted).

to guess what the state law is." *Id.*, 147. Certification is described as "a more rapid method than the use of the abstention doctrine and seems to be a much more orderly way of handling the problem." *Id.* The note remarks on the frequent use of Florida's certification procedure by the Fifth Circuit and by this Court. It adds that this Court "in *Clay* v. *Sun Insurance Office*, 363 U.S. 207, 212 (1960), seemingly urged the use of certification by the Court of Appeals for the Fifth Circuit." *Id.*, 149, and advocates a uniform act, to promote greater use of certification.

The proposed Uniform Rule, "patterned in large measure on Florida Appellate Rule 4.61", *id.*, 147 n.2, broadly authorizes certification of questions of state law "which may be determinative of the cause then pending in the certifying court and as to which it appears to the certifying court there is no controlling precedent. . . ." *Id.*, 150, §1.

The refusal of the majority below to employ certification is especially hard to accept since one member, and the only judge, on the panel of six lawyers who prepared the Uniform Act was Circuit Judge Waterman, who wrote the majority opinion below in this case. *Id.*, 17.

The American Law Institute has also voted its approval of a proposed codification of certification principles, which authorizes certification in a broad range of circumstances.[48]

48. ALI, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS, TENTATIVE DRAFT NO. 6 § 1371(e), at 39 (1968). The proposal provides, in full:

> "(e) A court of the United States may certify to the highest court of a state a question of State Law, if (1) the State has established a procedure by which its highest court may answer questions certified from such court of the United States; (2) the question of State law may be controlling in the action and cannot be satisfactorily determined in the light of the State authorities, and (3) the court expressly finds that

Recognizing that a certification system has substantial advantages to state jurisprudence, in addition to Florida, the states of Colorado[49], Hawaii[50], Louisiana[51], Maine[52], Maryland[53], Massachusetts[54], Montana[55], New Hampshire,[56] and Washington[57] have authorized their highest courts to answer questions of state law certified by federal courts.

6. Certification has been proved in practice.

In practice the Florida certification procedure has proved highly useful to the Court of Appeals for the Fifth Circuit, which includes Florida. Many Florida-law cases involve the difficult problem, presented in this case, of predicting whether the Supreme Court of Florida will choose to adopt a novel doctrine. *Hopkins* v. *Lockheed Aircraft Corp.*,

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certification will not cause undue delay or be prejudicial to the parties." *Id.*

The annexed commentary summarizes the advantages of certification over the usual abstention process:

> "Since the question will be certified to the highest state court, many of the delays incident to ordinary abstention orders, which require instituting a declaratory judgment action in a state court and prosecuting it through the state courts, may be avoided. Furthermore, the form of the question certified and the record sent to the state court with the certification are always under the control of the certifying federal court which can better assure that the right question will be answered on the right facts." *Id.*, 214.

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49. COLO. APP. R.21.1 (1970).

50. HAWAII REV. STAT. §§602-36, 602-37 (1963); HAWAII SUP. CT. R.20 (1968).

51. LA. REV. STAT. ANN. §13:72.1 (Supp. 1973).

52. ME. REV. STAT. ANN., tit. 4, §57 (1965).

53. MD. ANN. CODE art. 26, §161 (1973).

54. MASS. SUP. JUD. CT. RULES, R.3:21 (1971).

55. MONT. SUP. CT. R.1 (1967).

56. N.H. REV. STAT. ANN., §490: APP. R.21 (1968).

57. WASH. REV. CODE ANN. §§2.60.010-.030 (Supp. 1968); WASH. SUP. CT. R. ON APP. 1-67 (Supp. 1968).

358 F.2d 347 (CA5 1966), involved a question of conflicts, an area of rapidly changing law. The plaintiff maintained that Florida would follow an innovative New York Court of Appeals case, *Kilberg* v. *Northeast Airlines, Inc.*, 9 N.Y.2d 34 (1961), in ignoring, on public policy grounds, the limit on wrongful death recovery imposed by the state of the place of the wrong. In view of such decisions and commentary urging a "departure from the traditional doctrine," the Fifth Circuit certified the issue, 358 F.2d at 349. The Florida court expressly rejected the New York rule and held that Florida public policy did not conflict with such restrictions on recovery, *Hopkins* v. *Lockheed Aircraft Corp.*, 201 So.2d 743, 751 (Fla. 1967), adding that the case presented no "justification for abandonment of guiding principles in past decisions . . .," *id.*, 752. On receipt of this answer, the Fifth Circuit strongly endorsed certification in such a case, which presented the problem of "divining the policy considerations which the Supreme Court of Florida would now embrace. For policy it surely is." *Hopkins* v. *Lockheed Aircraft Corp.*, 394 F.2d 656, 656-57 (CA5 1968). Where an independent judgment would be "fraught with great hazards both to litigants and the law," *id.*, 657, certification gave a "clear, positive, final, decisive answer." *Id.* Summary judgment for the defendant was affirmed.

Certification has settled other questions of the Florida court's adherence to principles expressed in Florida precedents.[58]

58. See, *e.g.*, *Allen* v. *Estate of Carman*, 281 So.2d 317 (Fla. 1973) (employer's invocation of exclusive workmen's compensation coverage upheld by analogy with decisions under similar Florida statutes; scope of employment restricted by precedents); *Gordon* v. *John Deere Co.*, 264 So.2d 419 (Fla. 1972) (long-arm statute not retroactive since precedents require retroactive statutes to be explicitly "remedial"); *Boyd* v. *United States Fidelity and Guaranty Co.*, 256 So.2d 1 (Fla. 1972) (insurance coverage not construed broadly where unambiguous, under prior decisions); *Trail Builders Supply Co.* v. *Reagan*, 235 So.2d 482 (Fla. 1970) (workmen's compensation statute held not to alter third party's right to indemnity

The Fifth Circuit has properly refused to second-guess the Florida court's interpretations of state law, *National Educational Association* v. *Lee County Board of Public Instruction*, 467 F.2d 447, 449 (CA5 1972), and expressly understands this Court's ruling in *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* as approving its use of certification. *Martinez* v. *Rodriquez,* 410 F.2d 729, 731 n.5 (CA5 1969). Florida has maintained a record of prompt answers to Fifth Circuit certifications; it cannot be doubted that the system works in practice.[59]

This Court has had the benefit of Florida's answers to certified questions four times to date and in each instance demonstrated its advantages to the federal system.

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by employer under common law precedents); *Gaston* v. *Pittman,* 224 So.2d 326 (Fla. 1969) (suit by divorced wife against former husband for tort prior to marriage upheld under precedents analyzing abatement of right to sue); *Martinez* v. *Rodriquez,* 215 So.2d 305 (Fla. 1968) (father's action for death of child barred by mother's negligence under rationale of prior decisions); *Moragne* v. *States Marine Lines, Inc.,* 211 So.2d 161 (Fla. 1968) (Florida wrongful death action based on unseaworthiness rejected under theory of precedents, despite contrary out-of-state decisions and recent statutory amendments; any other course "tantamount to judicial legislation, *id.,* 167).

59. Cases Certified by Court of Appeals for the Fifth Circuit to the Supreme Court of Florida:

Case	Certification	State Decision	Disposition
Clay v. Sun Ins. Off. Ltd.	(unreported) 8-12-60	133 So.2d 735 10-18-61	319 F.2d 505 6-19-63
Green v. American Tobacco Co.	304 F.2d 70 6-20-62	154 So.2d 169 6-5-63	325 F.2d 673 12-11-63
Hopkins v. Lockheed Aircraft Co.	358 F.2d 347 3-24-66	201 So.2d 743 7-26-67	394 F.2d 656 5-16-68
Life Ins. Co. of Virginia v. Shifflet	370 F.2d 555 1-4-67	201 So.2d 715 5-31-67	380 F.2d 375 7-21-67
Martinez v. Rodriquez	394 F.2d 156 5-2-68	215 So.2d 305 10-30-68	410 F.2d 729 4-29-69
Moragne v. States Marine Lines, Inc.	(unreported) 7-11-67	211 So.2d 161 5-29-68	409 F.2d 32 4-1-70
Gaston v. Pittman	405 F.2d 869 1-17-69	224 So.2d 326 5-28-69	413 F.2d 1031 7-17-69
Trail Builders Supply Co. v. Reagan	409 F.2d 1059 4-7-69	235 So.2d 482 3-18-70	430 F.2d 828 8-12-70

The Court had earlier accepted certificates from state courts to clarify points of state law, see *King* v. *Order of United Commercial Travelers of America*, 333 U.S. 153, 160 (1948), but its first mention of the Florida procedure was in *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960), where the Court urged its use on remand. Speaking for the Court, Justice Frankfurter praised the procedure:

> "The Florida Legislature, with rare foresight, has dealt with the problem of authoritatively determining unresolved state law involved in federal litigation by a statute which permits a federal court to certify such a doubtful question of state law to the Supreme Court of Florida for its decision. Fla. Stat. Ann., 1957, §25.031." *Id.*, 212 (footnote omitted).

In *Dresner* v. *City of Tallahassee*, 375 U.S. 136 (1963), and again in *Aldrich* v. *Aldrich*, 375 U.S. 75 (1963), the Court directly determined Florida law by certification.[60] Mr. Jus-

Case	Certification	State Decision	Disposition
Boyd v. Bowman	443 F.2d 848 5-17-71	256 So.2d 1 11-24-71	455 F.2d 927 2-14-72
A. R. Moyer, Inc. v. Graham	443 F.2d 434 5-20-71	285 So.2d 397 10-10-73	
Allen v. Estate of Carman	446 F.2d 1276 7-7-71	281 So.2d 317 7-31-73	
Oliva v. Touchton	448 F.2d 437 9-16-71	(unreported dismissal) 6-15-72	
National Education Association v. Lee County Board of Public Instruction	448 F.2d 451 9-16-71	260 So.2d 206 3-15-72	467 F.2d 447 8-25-72
Gordon v. John Deere Co.	451 F.2d 234 11-16-71	264 So.2d 419 7-5-72	466 F.2d 1200 9-18-72

60. Clay was decided on the merits after the certified questions were answered and it was plain that a constitutional issue was presented, *Clay* v. *Sun Ins. Office, Ltd.*, 377 U.S. 179 (1964). The answers of the Supreme Court of Florida in *Dresner* enabled the Court to dismiss the writ of certiorari as improvidently granted, *Dresner* v. *City of Tallahassee*, 378 U.S. 539 (1964), and in *Aldrich* the Court reversed on the basis of the answers:

> "Given the answers of the Florida court, it becomes plain that the judgment of the Supreme Court of Appeals of West Virginia, based as it was on a misapprehension regarding the law of a sister State, cannot stand." *Aldrich* v. *Aldrich*, 378 U.S. 540, 543 (1964).

tice Douglas, concurring in *England* v. *Louisiana State Board of Medical Examiners, supra,* urged use of certification as a more expeditious alternative which would "lighten [the] requirements," *id.,* 432, of abstention:

> "We use [the Florida] procedure on Florida state law perplexities. . . . We cannot require the States to provide such a procedure,—but by asserting the independence of the federal courts and insisting on prompt adjudications we will encourage its use." *Id.,* 434 (concurring opinion).

This Court had the benefit of the answer to a question certified by the Fifth Circuit in *Moragne* v. *States Marine Lines, Inc.,* 398 U.S. 375, 377 (1970), which established a federal remedy for death caused by unseaworthiness. The Florida court stated that its wrongful death statute gave no recovery for death caused by a violation of the " 'completely foreign' maritime duty of seaworthiness," since it enforced only common-law duties. *Id.* 401 n.15. This statement prevented the recurrence of the doubts about state law which troubled the Court in *The Tungus* v. *Skovgaard,* 358 U.S. 588, 595-96 (1959), where the Court suggested abstention might be appropriate in such cases, even though no party had urged it, and enabled the Court to decide an important question of admiralty law, certain that the issue was squarely presented. Moreover, Florida's answer shed light on the problem as well, for the restrictive interpretation of the Florida court demonstrated the "incongruity of forcing the States to provide the sole remedy to effectuate duties that have no basis in state policy." 398 U.S. at 401 n. 15.

Enthusiasm for certification has also been expressed in the Second Circuit. In *Essex Universal Corp.* v. *Yates,* 305 F.2d 572 (CA2 1962), a case like this one involving the duties of corporate fiduciaries under state law, Judge Friendly emphasized the difficulty of predicting without

sufficient precedents what policy New York would adopt on such an issue "of enormous importance to all New York corporations and their stockholders," *id.*, 580 (concurring opinion). He noted that such problems had "led at least one state to authorize its courts to answer questions about its law that a Federal court may ask," *id.*, 580 (footnote omitted), and cited the Florida certification statutes, FLA. STAT. ANN. §§25.031, 25.032 (1961), which the Second Circuit refused to use in this case.

Cornellier v. *American Casualty Co.*, 389 F.2d 641 (CA2 1968), raised the unsettled question whether a coverage limitation in an accident insurance policy violated Vermont public policy. The Second Circuit noted that the need to "divine" state law "makes most attractive the Uniform Certification of Questions of Law Act," *id.*, 644 n.3, and pointed out that Florida and three other states had similar procedures.

Peterson v. *Allcity Insurance Co.*, 472 F.2d 71 (CA2 1972), concerned the measure of damages under New York law for an insurer's bad-faith refusal to settle a claim. The Second Circuit said the case illustrated the difficulty of determining New York law in this developing field and stated that the court might benefit from a "certification statute, similar to that now in effect in various other states, e.g., Florida . . ." *Id.* 80 n.14.

But here, when the opportunity arose to use such an "attractive" procedure, the Second Circuit refused and prevented an authoritative ruling:

> "The *Schein* court took no note of the utilization the Court of Appeals for the Fifth Circuit has recently made of [certification]. . . . Failure to utilize this procedure by the *Schein* court saps the decision's authority as an application of the law of Florida; it is questionable whether a Florida court would feel bound by *Schein*, should it be faced with a similar case." Note, *supra*, 53 B.U.L. REV. at 1158-59.

Instead, it undertook on its own to determine "a problem presenting fundamental and serious questions of state policy with only fragmentary case material with which to work," see *W. S. Ranch Co.* v. *Kaiser Steel Corp., supra*, 388 F.2d at 265 n.15. So doing, it disregarded Florida's statutorily declared interest in developing its own public policy for application in federal courts, ignored the parties' interest in the uniform application of Florida law, and defeated the public interest in the efficient operation of our national judicial system in a manner that settles questions fairly rather than fostering inequity and uncertainty. It failed to honor or even to discuss this Court's decisions requiring abstention and specifically encouraging the use of Florida's certification procedure, despite the firm and explicit protests of Judge Kaufman in dissent. Such action plainly requires reversal. It falls to this Court to remind the lower court that our judicial system encompasses both state and federal courts; that the supposed walls of separation between the court systems were erected by the law, that they can be, and have been here, pierced by the law to permit communication to achieve justice, and that in such case a court should not reject an authoritative statement of the governing law in order to impose its view of good policy upon the people of a distant jurisdiction.

In the face of the uncertainty and confusion created by the ruling below, one certainty remains, plain and incontestable: Florida has an answer for the crucial policy question that governs this case. And Florida has now, in operation, a proved system to provide that answer quickly and with precision. Florida *will* answer. Lehman's position is simple: Why not ask?

CONCLUSION

The judgment of the Court of Appeals for the Second Circuit should be reversed and this case should be remanded with instructions to certify the controlling issue of Florida law to the Supreme Court of Florida for decision by that Court.

Respectfully submitted,

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January 17, 1974

SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

October Term, 1973

No. 73-440

BENJAMIN SIMON,

Petitioner, et al.,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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January 17, 1974

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IN THE

Supreme Court of the United States

October Term, 1973

No. 73-440

BENJAMIN SIMON,

Petitioner, et al.,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

BRIEF FOR PETITIONER BENJAMIN SIMON

This brief is submitted on behalf of Benjamin Simon, the petitioner in No. 73-440.

Opinion Below

The opinion of the Court of Appeals is reported *sub nom. Schein* v. *Chasen,* at 478 F.2d 817 (2d Cir. 1973). The opinion of the District Court is reported *sub nom. Gildenhorn* v. *Lum's, Inc.,* 335 F. Supp. 329 (S.D.N.Y. 1971).